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October 15, 2004

The Honorable Vernon A. Williams
Secretary
Surface Transportation Board
1925 K Street, NW
Washington, DC 20423-0001

Re: Kansas City Southern-The Kansas City Southern Railway Company, Gateway Eastern Railway Company, and The Texas Mexican Railway Company; Finance Docket No. 34342

Dear Secretary Williams:

Pursuant to Decision No. 2, I am enclosing herewith an original and 27 copies of both a Highly Confidential and Public Version of the "Reply of Kansas City Southern, The Kansas City Southern Railway Company, Gateway Eastern Railway Company, And The Texas Mexican Railway Company To Additional Comments Filed September 30, 2004." A copy of this document in Word Perfect format is enclosed on each of the accompanying three diskettes in accordance with Decision No. 2 and 49 C.F.R 1104.3. As can be seen on the Certificate of Service, a copy of this filing has been served today upon all parties of records to this proceeding.

Please date-stamp the twenty-sixth and twenty-seventh copies of this letter and the accompanying filing, and return them to our representative for our files.

Sincerely,

William A. Mullins

Enclosure
cc: Parties of Record

PUBLIC VERSION

212237

KCS-22
TM-19

BEFORE THE
SURFACE TRANSPORTATION BOARD

FINANCE DOCKET NO. 34342

KANSAS CITY SOUTHERN

- CONTROL -

THE KANSAS CITY SOUTHERN RAILWAY COMPANY,
GATEWAY EASTERN RAILWAY COMPANY,
AND
THE TEXAS MEXICAN RAILWAY COMPANY

OCT 15 2004
RECEIVED

REPLY OF KANSAS CITY SOUTHERN, THE KANSAS CITY SOUTHERN RAILWAY COMPANY, GATEWAY EASTERN RAILWAY COMPANY, AND THE TEXAS MEXICAN RAILWAY COMPANY TO ADDITIONAL COMMENTS FILED SEPTEMBER 30, 2004

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October 15, 2004

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BEFORE THE
SURFACE TRANSPORTATION BOARD

FINANCE DOCKET NO. 34342

KANSAS CITY SOUTHERN

- CONTROL -

THE KANSAS CITY SOUTHERN RAILWAY COMPANY,
GATEWAY EASTERN RAILWAY COMPANY,
AND
THE TEXAS MEXICAN RAILWAY COMPANY

REPLY OF KANSAS CITY SOUTHERN, THE KANSAS CITY SOUTHERN RAILWAY COMPANY, GATEWAY EASTERN RAILWAY COMPANY,
AND
THE TEXAS MEXICAN RAILWAY COMPANY
TO ADDITIONAL COMMENTS FILED SEPTEMBER 30, 2004

Pursuant to the order of the Surface Transportation Board ("STB" or "Board") served August 31, 2004 herein ("Decision No. 11"),[1] Kansas City Southern ("KCS" or "Applicant"), The Kansas City Southern Railway Company ("KCSR"), Gateway Eastern Railway Company ("Gateway Eastern"), and The Texas Mexican Railway Company ("Tex Mex" or "TM") hereby reply to the four sets of additional comments filed on September 30, 2004.[2] KCS and Tex Mex will not repeat here their detailed rebuttal filed September 2, 2003 ("KCS-18/TM-17"), but rather will respond to the limited issues raised by the final four sets of comments.

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[1] *Kansas City Southern-Control-The Kansas City Southern Railway Company, Gateway Eastern Railway Company, and The Texas Mexican Railway Company*, STB Finance Docket No. 34342 ("*KCS-Control-Tex Mex*"), Decision No. 11 (served August 31, 2004).

[2] *I.e.*, comments filed by The National Industrial Transportation League ("NITL"); The U.S. Department of Transportation ("DOT" or "Department"); Canadian Pacific Railway Company ("CP"), and Union Pacific Railroad Company ("UP").

INTRODUCTION AND FRAMEWORK

A. Brief Procedural History

Just over one year ago, the Board issued Decision No. 10,[3] suspending the procedural schedule in this matter. Before that decision was served, KCS, Tex Mex and commentors alike had submitted all of their scheduled filings in the proceeding, compiling a fully-developed record. However, in light of TFM, S.A. de C.V.'s ("TFM's") repurchase of the stock of Mexrail, Inc. ("Mexrail") from KCS, the Board suspended the procedural schedule until such time as "KCS demonstrates that there is a reasonable likelihood that it will be able to acquire control of Tex Mex." Decision No. 10, slip op. at 3.[4] The Board's decision also required KCS to submit status reports to the Board every third month, and more often if events warranted. *Id.*

Following several tri-monthly status reports, KCS on August 16, 2004 submitted a special status report, notifying the Board that KCS had reached a revised agreement with TFM and its principal shareholder Grupo TMM, S.A. ("TMM") to again acquire the stock of Mexrail. KCS provided a copy of the revised agreement with the notice, and asked the Board to reinstate the procedural schedule and to move forward in deciding KCS's application. On August 31, the Board served Decision No. 11, granting KCS's request, reinstating the procedural schedule and calling for a final round of comments addressing changes to the Acquisition Agreement. In response, four parties filed supplemental comments. None request denial of the application,

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[3] *KCS-Control-Tex Mex*, Decision No. 10 (served October 8, 2003).

[4] The Board suspended the procedural schedule *only* because KCS appeared unable at that time to complete the Tex Mex transaction. The disruption of the TFM transaction was not, as claimed by DOT (*see* DOT's September 30, 2004 comments – DOT-7 - at 1-2), a basis for the Board's suspension order.

though all request one or more conditions on approval of the application. KCS and Tex Mex hereby reply to those comments.

B. The Appropriate Legal Framework For Approval of a Minor Transaction

In determining whether to grant this application and whether to impose conditions, the Board must determine whether substantial competitive harms are likely to result from the transaction. If it concludes that such harm will not occur, the Board need not even consider whether the transaction benefits the public interest.[5] Even if it concluded that such harms would occur, however, the Board would nevertheless be required to grant the application unless it found that the projected harm outweighed the benefit to the public interest of granting the application and could not be sufficiently ameliorated by conditions. *E.g., Illinois Central Corporation And Illinois Central Railroad Company-Control-CCP Holdings, Inc., Chicago, Central & Pacific Railroad Company And Cedar River Railroad Company*, 1996 STB LEXIS 157 at *7-*8 (served May 14, 1996).

Parties opposing the application or seeking conditions bear the burden of proving competitive harm and any such showing must be made by substantial evidence.[6] To warrant a condition, the alleged harm must be substantial; it must be more substantial than just "some harm," and cannot be small or merely transitory. *See Wisconsin Central Transportation Corporation-Continuance In Control-Fox Valley & Western Ltd.*, 1993 MCC LEXIS 106 at *5-

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[5] The public interest standards of Section 11324(c) do not apply to minor transactions. *See Illinois v. Interstate Commerce Commission*, 687 F.2d 1047, 1053 (7th Cir. 1982).

[6] *Kansas City Southern Industries, Inc.-Control-Midsouth Corporation*, Finance Docket No. 32167, 1994 ICC LEXIS 75 at *5-*6 (served May 4, 1994). *See also Rio Grande Industries, Inc.-Purchase and Trackage Rights- Chicago, Missouri & Western Ry. Co.*, 1989 ICC LEXIS 284 at *35 (served Sept. 27, 1989)("The statute thus clearly puts the burden on an opposing party to prove competitive harm.").

*6 (served July 23, 1993) (analysis under former Section 11344(d)). The harm must also be to *competition*, not harm to a particular railroad competitor. *Wisconsin Central Transportation Corporation-Continuance In Control-Fox Valley & Western Ltd.*, 1992 ICC LEXIS 279 at *10 (Dec. 4, 1992) ("A showing of expected substantial harm to a particular competitor as a result of a transaction is not equivalent to a showing of harm to competition."). no party has produced substantial evidence that the KCS/TM transaction or, for that matter, the KCS/TFM transaction, will result in substantial harm to competition so as to warrant imposition of a condition.

Some commentors have sought in this proceeding to alter this statutory standard.[7] These commentors do not focus on the transaction that is subject to the Board's jurisdiction and approval - the KCS/TM transaction - but rather want this Board to act as if it has jurisdiction over KCS's efforts to acquire TFM, then examine the competitive effects of that transaction using the policy and standards of the major merger rules, and then condition the KCS/TM transaction on alleged effects arising out of the KCS/TFM transaction. These commentors, in particular UP and CP, have renewed such requests in their September 30, 2004 additional comments. As KCS has said throughout this proceeding, there are serious jurisdictional and legal problems associated with such an approach. Furthermore, as discussed subsequently herein, Section III, *infra*, not only are there significant legal issues with respect to various parties' requests to condition this transaction based on alleged effects arising from the KCS/TFM

[7] DOT, for example, advocated in its September 2, 2003 comments (adopted by reference in its September 30, 2004 comments) that, although the transactions did not involve a merger of two Class I carriers, the Board's rules governing such mergers should nevertheless be applied because of the importance of the Laredo gateway. Of course, these attempts to alter the statutory standards applicable to this case must fail. The Board cannot treat this case as a merger of Class I carriers without violating both the ICC Termination Act of 1995 ("ICCTA") and the specific terms of the Board's own regulations. *See* 49 C.F.R. §1180.1 ("General policy statement for merger or control of *at least two Class I railroads*" [emphasis added]), and 49 C.F.R. §1180.0(b) (waiving application of the major merger regulations to KCS).

transaction, but even if the Board could condition this transaction on that basis, no party has shown, either in its original comments or its supplemental comments, that the proposed KCS/TFM transaction will have anticompetitive effects warranting imposition of a condition.

C. A Brief Review Of The Previous Record Shows That No Party Has Met The Burden Of Proof For Imposition Of A Condition

The record assembled before the Board prior to suspension of the procedural schedule fully supported a grant of KCS's application without conditions because no competitive harm from the transaction had been, or indeed could be shown. The uncontested record showed that no shipper would lose a competitive alternative as a result of this transaction. Indeed, competitive alternatives will be strengthened because KCS control of Tex Mex will make Tex Mex a stronger railroad connection for both KCSR and BNSF.

In their filings last year, commentors addressed a wide range of issues, including issues related to KCS's proposed acquisition of a controlling stock interest in TFM. Shippers overwhelmingly supported the transaction, while KCS's competitors, principally BNSF and UP, sought to gain competitive advantage through a variety of requested conditions. These conditions included BNSF's request for a five-year freeze on Tex Mex and TFM divisions for traffic interchanged with BNSF, and UP's requests for the Board to (a) inject itself into the details of how the International Rail Bridge at Laredo is operated, and (b) create a system that would control TFM's rates for shipments interchanged with UP. All of these requested conditions were based on a series of hypothesized anticompetitive actions that KCS theoretically might take, none of which were shown to be either likely or substantial.

For its part, KCS repeated again and again its commitment to keep the Robstown and Laredo gateways open on commercially reasonable terms. *E.g.*, Transcript of July 31, 2003 hearing before the Board ("7/31 Transcript") at 13 (testimony of Michael R. Haverty) and 165 (testimony of Gerald K. Davies). It stated that it did not have any plans to change the neutrality of the operation of the Laredo bridge, 7/31 Transcript at 10 (testimony of Michael R. Haverty) and 167, 173-175 (testimony of Gerald K. Davies), nor did KCS plan to alter the operations of TFM because KCS might gain control of the majority shares in that company. 7/31 Transcript at 166, 175-176 (testimony of Gerald K. Davies). KCS pointed out that the majority of traffic handled by TFM and Tex Mex was, respectively, traffic interchanged with UP and BNSF and was, in one way or another, captive to UP and BNSF or at least not available to KCS. *E.g.*, 7/31 Transcript at 10, 11 and 13 (testimony of Michael R. Haverty), and 160-162 (testimony of Gerald K. Davies); KCS-18B/TM-17B, Rebuttal Verified Statements of Gerald K. Davies (Tab F) at 10-12 and Bengt Mutén (Tab G) at 4-8. Therefore, anticompetitive actions that crippled UP's or BNSF's ability to handle such traffic, KCS pointed out, would simply move traffic off of TFM and Tex Mex, a result antithetical to KCS's interests as a stockholder of each. KCS-18B/TM-17B, Rebuttal Verified Statement of Gerald K. Davies (Tab F) at 10-12.

Moreover, the evidence showed that KCS control of Tex Mex would enable KCS to share resources more fully with Tex Mex. KCS/Tex Mex Application ("KCS-3/TM-3"), Operating Plan at 227-230. These resources will give Tex Mex added marketing capabilities, greater access to engineering and other specialized expertise, access to a larger fleet of equipment, greater access to capital needed for infrastructure, and other benefits not previously available to Tex Mex. *Id.*, and KCS-3/TM-3 at 139-142 (Verified Statement of James L. Riney) and 145-148 (Verified Statement of Steven L. Hefley). These added resources will make Tex Mex a stronger link in U.S.-Mexico trade, aiding not only KCSR but also BNSF in competing against UP.

The record shows that shippers understand the pro-competitive benefits of KCS control of Tex Mex. Over 90 shippers and shortline carriers that originate or terminate traffic submitted statements supporting KCS's application. *E.g.*, KCS-3/TM-3 at 232-312 (support statements); 7/31 Transcript at 95-150 (testimony of Rick Webb, Edward P. deZevallos, Chris Osen, William J. Fellows, Gary A. Beachner, Albert S. Foley and Ned Wright). Impressively, the U.S. Department of Agriculture, which ordinarily has opposed recent rail consolidations, testified in favor of the KCS-Tex Mex proposal. 7/31 Transcript at 28-37. In addition, the NITL, with approximately 700 shipper and carrier members, endorsed the KCS application along with KCS's agreement with the League to implement pro-competitive protections for shippers if it gained control of Tex Mex and/or TFM. *See* NITL-3. NITL renewed that support in its September 30, 2004 comments, NITL-7.

Far from threatening a likelihood of substantial competitive harm, KCS control of Tex Mex promises a likelihood of strengthened competition. This conclusion is not altered when one considers KCS's plans to acquire control of TFM. Accordingly, and in light of the vast competitive strength and leverage of the other rail carriers serving Mexico directly – UP and BNSF, each of which dwarfs KCS in terms of number of points served and each of which has access to multiple Mexico gateways – the record assembled last year showed that this application should be granted without imposing the burdensome conditions sought by KCS's competitors to protect their own interests.

D. The Changes That Have Occurred Over The Past Year Provide Further Support For KCS's Position

The Board's August 31, 2004 decision (Decision No. 11) to resume the procedural schedule provided parties with an opportunity to address the changes in the KCS/TM transaction and to provide evidence on whether or not the events of the past year have changed the fundamental pro-competitive nature of the transaction before the Board. As noted, only three parties filed additional comments expressing any concern about either the KCS/TM transaction or the KCS/TFM transaction. Ultimately, these comments raise three issues requiring further discussion – (1) whether to impose conditions requiring the Board to micromanage operations of the International Rail Bridge at Laredo; (2) whether additional commitments are necessary to maintain the Robstown interchange with BNSF; and (3) whether the Board can or should seek to manipulate pricing or service options on TFM in Mexico in order to protect UP's and CP's divisions. Each of these issues is addressed in detail in Sections I, II, and III, *infra*, but before doing so, it is important to briefly discuss the factual changes that have occurred in the past year. These factual changes only provide further support for one fundamental truth – that both the KCS/TM transaction and the KCS/TFM transaction are pro-competitive in nature.

1. This Transaction and The TFM Transaction Remain Independent But Related Transactions

The revised KCS-TFM-TMM agreement for KCS to acquire the controlling shares of Mexrail is in all material respects the same as that originally presented to the Board. Meanwhile, as KCS said repeatedly last year, the TFM transaction remains a separate but related matter, with KCS and TMM not yet in agreement to move forward and needing to seek renewed Department of Justice review if that transaction is to proceed.

The revised Stock Purchase Agreement for KCS's acquisition of Mexrail's stock is not materially different from the April 2003 agreement for the transaction. The substantive differences between the original and revised agreements are:

- Now, TFM has no right to repurchase the Mexrail stock.
- Now, KCS has an obligation, not merely an option, to acquire the remaining Mexrail shares. That acquisition must be completed by October 31, 2005.

- Now, certain Tex Mex debt to TMM and TFM has been or shortly will be repaid, while most Tex Mex debt to TFM has been capitalized, rather than being assumed in the acquisition.
- Now, KCS has obligated itself in the agreement to abide by known current written agreements governing operation of the Laredo Bridge, and has given TFM the 5-year right of first refusal to reacquire the north half of the bridge should a KCS-controlled Mexrail attempt to sell that half of the bridge.

These changes to the agreement are immaterial to the Board's consideration of the limited issues before the agency. First, TFM's lack of a repurchase option merely means that the Board can expect to move forward to completion of this proceeding without further interruption. Second, KCS's obligation to purchase the remaining Mexrail stock by October 31, 2005 is immaterial because once the agency approves common control, further increasing one's ownership interest does not require further approval.[8] Third, no party has raised an issue with respect to the financial aspects of the Mexrail acquisition, so contract provisions relating to repayment and capitalization of debt do not raise matters of concern to the Board. Fourth, the contractual provision that KCS will honor the bridge agreements that are already of record in this proceeding, and which would allow TFM to purchase the bridge even if the TFM acquisition proposal is not completed, merely reinforces the security that all parties should feel about bridge

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[8] *See Union Pacific Corporation, Union Pacific Railroad Company and Missouri Pacific Railroad Company—Control—Chicago and North Western Transportation Company and Chicago and North Western Railway Company*, Finance Docket No. 32133 (ICC served March 7, 1995) ("*UP-CNW*"), slip op. at 59, *citing Canadian Pacific Limited and Soo Line Corporation—Petition for Declaratory Order*, Finance Docket No. 31592 (ICC served Jan 18. 1990). (It should be noted that in *UP-CNW*, the Board's evaluation of the later-contemplated acquisition dealt with parties already subject to its jurisdiction in the primary application.)

operations. In short, the changes to the Mexrail stock purchase agreement do not raise any new issues before the Board. No party raised issues about these changes in its September 30, 2004 comments.

The relationship between the transaction before the Board and KCS's proposal to acquire a controlling interest in TFM likewise is not materially different now than it was in 2003; that is, they remain separate, albeit related, transactions. However, while the KCS/TM transaction is a definite, the KCS/TFM transaction, if it is to move forward, is still subject to extensive negotiations between TMM and KCS and further review by appropriate authority other than the Board. While KCS remains hopeful that it will reach an agreement with TMM regarding control of TFM, there are still outstanding issues that need to be negotiated. Notwithstanding these outstanding commercial issues, KCS has moved forward with obtaining appropriate regulatory approvals in Mexico. KCS has obtained approval of the Mexican Federal Competition Commission[9] and the Mexican Foreign Investment Commission ("FIC").[10] However, last year's Hart-Scott-Rodino approval by the U.S. Department of Justice has expired and will have to be sought again (assuming a similar transactional structure) once the parties have reached an agreement to move forward on the TFM acquisition.

In short, the relevant facts about the revised Mexrail stock purchase agreement and the separate proposal for KCS to acquire a controlling interest in TFM are fundamentally the same now as they were when the Board suspended the procedural schedule last October. As a consequence, KCS's previous evidentiary filings establishing the pro-competitive nature of the proposal before the Board remain valid and compelling.

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[9] Approval extended to April 5, 2005. *See* October 8, 2004 Status Report to the Board.

[10] Approval granted to October 5, 2005. *See* October 6, 2004 Status Report to the Board.

2. The Past Year Proved Pacer's Request for Board Management of MCS Implementation on Tex Mex Was Unnecessary

Last year, Pacer International, Inc. ("Pacer") argued that implementation of KCS's Management Control System ("MCS") on Tex Mex could lead to substantial operational problems on Tex Mex, and requested the Board to intervene in the planning and implementation of that changeover. Without such steps, Pacer predicted that MCS implementation "could cause severe train delays and congestion throughout the new NAFTA Rail network and the networks of other carriers, including taking down the Laredo Bridge for periods of time." PI-4 at 16.

Contrary to Pacer's prediction, MCS was implemented on Tex Mex in April 2004 without significant difficulty. Under a contract between KCS and Tex Mex,[11] implementation of MCS was planned and effectuated smoothly by KCS and Tex Mex personnel, without any major train delays and without any need for public comment or Board approval as requested by Pacer. This system is already yielding benefits for Tex Mex. It has, for example, allowed KCS and Tex Mex to direct TFM how to block northbound trains to minimize operational complexities and to prevent Tex Mex from having to switch traffic enroute from TFM to KCS. This makes the TFM-Tex Mex-KCS routing more efficient and more competitive. The Board intervention requested by Pacer in these day-to-day operating issues would have added nothing to implementation of MCS on Tex Mex. Pacer did not renew any of its prior comments on September 30.

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[11] The MCS implementation on Tex Mex was tailored, however, to prevent sharing shipper data that would be improper prior to approval of this application.

3. The Past Year Has Shown That Norfolk Southern's Concerns About Investment in the Meridian Speedway Were Misplaced

The past year has also dispelled the concerns expressed by Norfolk Southern Railway Company ("NS") that efforts to control Tex Mex and TFM would divert KCS's attention from the Meridian Speedway. Since March 2003, KCS has taken the following steps, in addition to normal maintenance, to improve the capacity and operations of the Meridian Speedway:

- Completed a new siding at Bovay, LA, enabling opposing trains to pass and allowing staging of trains at Vicksburg, MS;
- Made improvements to the Shannon siding, including removal of three grade crossings;
- Completed an 8500-foot extension of the siding at Gibsland, LA, providing a 9800-foot siding with no road crossings;
- Constructed a new, 8500-foot siding at Morton, MS, between the Brandon and Lake sidings, cutting the distance between sidings by half and cutting train wait time by 45 minutes to an hour;
- Purchased 2+ acres of land at Vicksburg, MS, in order to reduce the curvature of the main line at Vicksburg and reduce the risk of derailments (KCS has already begun to realign the line at that location);
- Double tracked the main line at Jackson, MS, between the CN connection and the west end of Jackson;
- Begun grading for double tracking the main line between Monroe and Magenta, LA, to separate the main line from yard operations in order to increase train velocity;
- Begun grading for two 6800-foot receiving tracks in High Oak Yard at Jackson, MS;
- Begun construction of a 40-car set out track at Gibsland, LA, to allow trains to pick up local traffic without using the passing siding;
- Made improvements to the ties, track and switches in Deramus Yard at Shreveport; and
- Begun expansion of the DeQuincy, LA yard.

In addition, KCS has installed approximately 30 power switches on the Meridian Speedway during the 2002-2004 periods, and entered into a corridor grade crossing safety improvement agreement with the Mississippi Department of Transportation, providing for warning level upgrades, crossing closures and other changes affecting all 88 crossings between Meridian and Vicksburg. These capital improvements on the Meridian Speedway show that

NS's concerns that investments would not be made on the Speedway were misplaced. NS did not reiterate those concerns on September 30.

4. The Past Year Has Shown That UP's Concerns Regarding Operations And Capacity At the Laredo Bridge Were Unfounded

Despite evidence that operations and capacity at the Laredo bridge have significantly improved in recent years, UP claimed in its 2003 comments (as it does in its September 30, 2004 filing) that new bridge operating protocols are needed. Yet, despite UP's assertions, operations at the bridge during the past year have continued smoothly, with all involved parties continuing to cooperate and coordinate on their operations at the bridge. In fact, TFM, with Tex Mex's support, undertook a new initiative with UP to further improve operations at the border crossing, agreeing to inspect northbound trains to be interchanged by TFM to UP in accordance with Federal Railroad Administration ("FRA") requirements so that UP could avoid repeating the inspections in UP's downtown Laredo yard. UP's application to the FRA, seeking an FRA waiver to allow movement of TFM-UP trains into the U.S. without a UP Laredo inspection, recites a number of improvements that the proposal will bring to cross-border operations at Laredo. *See* Supplemental Verified Statement of Erasmo Santos, attached as Exhibit B hereto ("Supplemental V.S. Santos") at 71 & 72. The bridge is also operating fluidly and has significant additional capacity. Supplemental V.S. Santos at 71 & 72; Supplemental Verified Statement of Gerald K. Davies, attached as Exhibit A hereto ("Supplemental V.S. Davies") at 58. Pending regulatory changes may create even more fluidity. (See Section I.A.1, *infra*.) In short, although UP's and DOT's comments will be addressed in detail below, nothing that has occurred over the past year supports UP's previous assertions about the alleged lack of capacity on the bridge.

5. The Past Year Has Proven That Private Sector Solutions Can Work Without The Need For Government Intervention

BNSF's 2003 comments disclosed that it entered a 5-year rate agreement with Tex Mex in December 1998 setting forth the various rates and rate factors (divisions) that BNSF could use in marketing BNSF joint-line service to Mexico through the Laredo gateway. That agreement was set to expire in December 2003. Not satisfied with KCS's commitment to continue providing BNSF with a Robstown interchange for Laredo-bound traffic or with the NITL agreement, which implemented KCS's commitment, BNSF asked the Board to freeze Tex Mex's (and TFM's) divisions in place for another five years.

With KCS's knowledge, Tex Mex granted BNSF a one-year extension of the BNSF-Tex Mex rate agreement, which is now set to expire on December 31, 2004. Furthermore, when KCS announced its renewed agreement to purchase control of Mexrail and Tex Mex, BNSF and KCS again began discussions to address some of BNSF's concerns and to address some of KCS's concerns about the need to provide adequate revenues to the Tex Mex, which in the past has been losing money. These discussions have proven fruitful, and KCS and BNSF have reached an agreement which, combined with the NITL agreement, KCS believes should address BNSF's concerns. In an indication that KCS's belief is correct, BNSF has not renewed its request for conditions in the latest round of comments.

Such discussions were simply an outgrowth of KCS's continued commitments throughout this proceeding to work with any party to address issues in the context of privately negotiated solutions without the need for STB intervention. KCS believes strongly that it will be able to work together with BNSF on a going-forward basis to provide invigorated competitive alternatives to UP's service over Laredo. Likewise, KCS believes it can work with all parties to develop mutually acceptable agreements. It is the marketplace that best resolves issues and it can do so without the need for government oversight or the ability for parties to use government imposed solutions if they do not get their way in private sector negotiations.

ARGUMENT

I. UP'S SEPTEMBER 30 COMMENTS DO NOT ALTER THE CONCLUSION THAT EXISTING AGREEMENTS AND PROTOCOLS FOR OPERATION OF THE LAREDO BRIDGE ADEQUATELY ENSURE NON-DISCRMINATORY TREATMENT

In its September 30 additional comments, UP once again claims that the existing agreements governing dispatching and control of the northern half of the International Rail Bridge at Laredo ("Laredo Bridge") are inadequate to prevent KCS from using its control of Tex Mex to "disadvantage" UP-TFM routings. UP wants the Board to impose a condition requiring KCS to negotiate a new protocol with it and, absent KCS's consent to such a new protocol, UP asks to have such a protocol developed and imposed by the Board. KCS and Tex Mex extensively addressed this argument in their September 2, 2003 Rebuttal Comments, *see* KCS-18A/TM-17A at 16-24, and nothing has occurred over the past year to change KCS's conclusions. Nonetheless, given that UP has again addressed the issue, it is important to briefly address UP's renewed comments and to again show why UP's suggested condition is unwarranted and unnecessary and should be rejected.

A. <u>UP Has Not Established That KCS's Control Of Tex Mex Will Cause Competitive Harm At The Laredo Bridge</u>

Like last year, UP has produced only meritless speculation that KCS's control of Tex Mex and the north end of the Laredo Bridge will harm competition. UP's speculation does not meet the statutory test that a party seeking conditions must meet; *i.e.*, demonstrating by substantial evidence a likelihood of substantial harm to competition. In a minor transaction such as this, a party requesting a condition bears the burden of proving that the condition is needed to remedy a harm that is both likely and substantial. The proposed condition also must be narrow in scope. UP has not made these showings. In fact, UP actually agrees with KCS and Tex Mex that the bridge is now operating well. UP's speculative and suspect claims that problems may arise in the future do not justify the sweeping conditions UP requests.

1. The Agreements Have Worked In The Past And They Will Work For The Future

For over fifty years, the existing agreements and protocols have governed operation of the Laredo Bridge without to our knowledge incident or complaint of any systemic problem (except for the amount of compensation to be paid by UP to Mexrail and Tex Mex). In fact, KCS, Tex Mex and UP all agree that efficiency in the operation of the bridge is probably at an all-time high. Last August, UP's witness Steve Barkley testified to the smooth operation of the bridge:

> In recent years, the three railroads that use the Laredo Bridge have made great strides in improving the efficiency of movements over the Bridge. . . . In addition, the railroads have made extensive efforts to improve their operating practices, so that movements across the Bridge are as fluid as possible. . . . In recent years, the railroads have worked hard to coordinate the timing of movements over the Bridge. . . . In addition, the railroads have pre-blocked cars for each other, allowing some trains to bypass the yards of the receiving carrier in the Laredo area. . . . The many operational improvements the railroads have made over the years, along with infrastructure additions and improvements in government clearance and inspection procedures, have resulted in major improvements in efficiency.

Union Pacific Railroad Company's Comments (UP-7B), Verified Statement of Stephen R. Barkley at 5-8.

All of these improvements occurred while KCS: (i) owned a substantial minority interest in Mexrail and an indirect interest in Tex Mex; (ii) was responsible for dispatching of Tex Mex's operations; (iii) had representation on the boards of Mexrail and Tex Mex; and (iv) had super-majority provisions at TFM and Grupo TFM that could block certain corporate actions undertaken by Tex Mex or TFM. In other words, KCS was part of the cooperative effort that has improved the efficiency of operations over the Bridge during the last few years. KCS participated in and supported these actions because it was in its economic interest to do so. Nothing in these transactions will change those economic incentives.

As a matter of fact, and despite the lapse of nearly 14 months since Mr. Barkley's statement, UP still has not come forward with evidence of any competitive problem with the operation of the bridge under the current agreements or proof that KCS will take a different approach.[12] UP has been unable to cite to even one example where KCS will take a different approach than what has been taken in the past or where KCS has not supported the cooperative actions undertaken by Tex Mex or TFM with respect to the Laredo Bridge. The record before the Board eviscerates any contention that the operation of the Laredo Bridge is causing, or is likely to cause, competitive problems requiring the imposition of conditions in this transaction.

Because KCS has no plans to competitively disadvantage UP by changing the bridge operations (*see* Supplemental V.S. Davies at 58; Supplemental V.S. Santos, 71 and 72), it is not surprising that UP has been unable to establish that KCS has future incentives to use its control of Tex Mex to discriminate against UP. KCS has had and will have the same incentives as Tex Mex—to put as much traffic as possible over the bridge to maximize revenues to both Tex Mex and TFM. As Chairman Nober noted at the July 31, 2003, Public Hearing and as Mr. Davies notes in his Supplemental V.S.:

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[12] UP also has not disproved KCS and Tex Mex evidence that the bridge has substantial available capacity. *See* 7/31 Transcript at 174 (testimony of Gerald K. Davies). *See also* KCS-18B/TM-17B, Verified Statement of James L. Riney (Tab C) ("V.S. Riney") at 4. Substantial unused capacity remains available today. Supplemental V.S. Davies, Exhibit A at 3; Supplemental V.S. Santos, ¶ 5.

> [I]f it were in KCS's larger interest now to raise rates, constrain UP's use, or otherwise manipulate UP's use of the bridge to try to derive more revenue for Tex Mex, the same actions would have been in Tex Mex's interest in the last several years as well, but those actions did not occur. Chairman Nober is right. It did not happen then and it will not happen in the future.

Supplemental V.S. Davies at 58.

If anything, the future offers the prospect of even further improvement in bridge operations under the existing agreements. As Mr. Riney testified, it is anticipated that train speed through the gamma ray scanner at the Laredo Bridge will eventually increase. V.S. Riney at 4. Also, UP, TFM, and Tex Mex have recently cooperated on a waiver petition to FRA[13] to eliminate duplicative train inspections. If granted, the waiver should eliminate a source of potential delays in moving TFM-UP trains through Laredo. Supplemental V.S. Santos, at 72-73. Finally, a recent change to FRA drug testing regulations also holds out the possibility that trains may not have to be stopped on the bridge to change crews,[14] potentially eliminating another source of delay in moving trains over the bridge.

2. UP's Concerns Are Speculative And Unfounded

As the basis for its claim that the KCS/TM transaction will harm competition at the Laredo Bridge, UP asserts that control of Tex Mex by KCS might, just might, allow KCS to interpret the existing bridge agreements in a way that UP says would disadvantage them. Of course, neither KCS nor Tex Mex has interpreted the existing agreements in the way UP

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[13] *Union Pacific Railroad Company Request for Air Brake and Inspection Waiver*, FRA-2004-18746 (filed July 29, 2004) ("UP's FRA Waiver Petition").

[14] *See* 70 Fed. Reg. 19270 (April 12, 2004) (notice modifies regulations with respect to employees of foreign railroads to allow them to operate trains up to 10 route miles into the U.S. without having to comply with certain portions of the drug and alcohol testing regulations).

suggests, nor that would it be in KCS's economic interest to do. Supplemental V.S. Davies at 57; Supplemental V.S. Santos, at 71.

UP claims that "Tex Mex has argued that its southbound trains, or blocks of cars TFM is sending northbound to Tex Mex, should receive 50 percent of the available slots," UP-7B, V.S. Barkley at 9, though "To date, TFM's Border Superintendent has resisted the Tex Mex arguments." *Id.* at 10. However, TFM's Border Superintendent Erasmo Santos testified that such arguments were never made to him,[15] and Jim Riney, General Manager of Tex Mex, said that there was "absolutely no basis" for UP's claim. V.S. Riney at 6. Mr. Santos likewise rejected UP's suggestions that he would favor KCS or Tex Mex, V.S. Santos at 3, or that, with his office in UP's facilities in downtown Laredo, he was any less available to UP than previously. *Id.* at 4. In his Supplemental V.S., Mr. Santos reiterates these points. Likewise, Mr. Davies addresses UP's argument in his Supplemental V.S. and explains why it would be against KCS's economic interest to adopt the interpretation suggested by UP, especially given that there is plenty of capacity on the Laredo Bridge. Supplemental V.S. Davies at57-58. In the end, UP's claim that KCS or Tex Mex will take actions to deliberately discriminate against UP at the Laredo Bridge is thoroughly refuted by those with first-hand knowledge of the facts.[16]

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[15] "During the nine years that I have been employed by TFM, no one from Tex Mex has ever made such an argument." KCS-18B/TM-17B, Vol. 2, Verified Statement of Erasmo Santos (Tab D) ("V.S. Santos") at 2.

[16] If there is any discrimination going on regarding competition for U.S.-Mexico traffic, it is UP who is doing it as they continue to refuse to meet their obligations to maintain Tex Mex's transit times over the UP lines used to connect Tex Mex with KCS. In fact, UP's FRA Waiver Petition contained UP data showing that its market share at Laredo increased 7.1% from 1999 to 2003. During that same period, Tex Mex's average transit time from Robstown to Beaumont almost doubled. Supplemental V.S. Davies at 57, n.1. For UP to suggest in this proceeding that the Board should fix competitive problems that don't even exist, while refusing to fix real competitive problems that it is causing, is simply hypocritical.

The evidence shows that the Laredo Bridge is operating as efficiently now as perhaps it ever has. All of this has occurred with the support and encouragement of KCS, and KCS has no plans to change those operational efficiencies. Accordingly, UP's request for protection against positions that it asserts that Tex Mex "might" take in the future is simply too nebulous and uncertain to warrant imposing any conditions. The agreements have worked well for over fifty years and they should be allowed to continue to work. In short, "if it ain't broke, don't fix it."

B. UP's "Fix" Is Not Narrowly Tailored And Is Inconsistent With UP's Previous Positions

Notwithstanding the high level of cooperation between all of the parties, including KCS, regarding operations over the Laredo Bridge, the fact that the agreements have worked for over fifty years without discrimination, and the fact that KCS has committed to the shippers and others that it will not discriminate against UP at the Laredo Bridge, UP insists that a condition is still warranted. As the "fix" for the alleged threat that KCS "might" use its control of Tex Mex to discriminate against UP, UP wants the Board to order KCS to negotiate a new agreement and new bridge protocols, and absent the ability of KCS and UP to agree, UP wants the Board to impose new protocols. UP claims that such a condition is merely the means of implementing KCS's commitment, but it is not. It goes much further and would place the Board in the position of having to impose new agreements over something that has previously been negotiated, and is working efficiently. The parties that actually use the bridge are in the best position to know what best accommodates every user's needs. In short, bridge usage is better left to negotiations in the marketplace.

KCS has always believed that the existing agreements and existing arrangements work fine, and as Mr. Davies notes, "KCS has absolutely no plans to change any of the existing practices governing the bridge." Supplemental V.S. Davies at 58. Dispatching over the bridge will continue to be housed and done out of the UP facility in downtown Laredo and will remain subject to UP involvement. There will be daily calls and monthly meetings to resolve both immediate and long term concerns, and KCS intends to work with UP to increase efficiency and capacity. *Id.* As a result, there is simply no need to negotiate a new agreement or new protocols.

Nonetheless, because of UP's fears regarding the transaction and its desire to reach new protocols, KCS agreed, prior to TFM's repurchase of Mexrail's stock last year, to sit down with UP to negotiate over their concerns and issues. This willingness to negotiate was not recognition on KCS's part that the existing arrangements were inadequate or that new protocols needed to be adopted. Instead, as KCS has often said, it will sit down with any party who has a concern to discuss mutual ways in which to resolve those concerns. Those negotiations stopped when TFM notified KCS that it intended to reacquire the Mexrail shares, and UP did not approach KCS again on new bridge protocols after KCS announced the renewed agreement to acquire controlling shares of Mexrail. Rather UP's first approach was to the Board, complaining that KCS had not come back to UP. Supplemental V.S. Davies at 59.

KCS remains willing to sit down with UP again, but, as UP itself has said in the past, the Board should not involve itself in private negotiations or impose an agreement merely because UP and KCS are unable to agree on new protocols, especially when the existing agreements and protocols have not been shown to be inadequate. Indeed, rewriting those agreements could jeopardize those and future efficiency gains. Operation of the Laredo Bridge requires flexibility. V.S. Santos at 3; V.S. Riney at 6; Supplemental V.S. Santos at 71 and 73. Trying to write a set of rules governing operation of the bridge and having them imposed by this Board would undercut this essential flexibility. The current system, which has allowed experienced operators the flexibility to maintain and improve bridge operations, despite increasing traffic levels, is superior to UP's request that the Board write new rules locking in the number of crossing slots available to UP and guaranteeing UP its request for "priority for movements over the Bridge." UP-7A at 101.

UP's preference here for a Board-imposed agreement based upon potential or speculative harms is stunningly at odds with UP's positions in prior cases. In numerous prior cases, UP has asserted that the Board should not involve itself in rewriting or changing existing private agreements even if doing so would be "pro-competitive" or "fix" what parties asserted was an anticompetitive problem. UP has consistently argued that the marketplace should be allowed to work and that the Board should not intervene in those negotiations to impose an agreement. For example, responding to DM&E's request that the Board rewrite the agreement granting DM&E access to UP's unused track at Owatonna, IA, UP said:

> UP is prepared to negotiate an agreement under which DM&E would be permitted to connect with IC&E via existing trackage at Owatonna. Board intervention is thus both unnecessary and undesirable, as it would interfere with the parties' reaching a negotiated agreement. One way or the other, DM&E will connect with IC&E without Board involvement, and it would disserve the public interest for the Board to short-circuit efforts to reach a marketplace solution.

Comments of Union Pacific Railroad Company, UP-4 (dated Nov. 14, 2002) at 6 in DM&E/IC&E.[17] In its DM&E/IC&E decision, the Board adopted UP's position.[18] Similarly,

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[17] *Dakota, Minnesota & Eastern Railroad Corporation and Cedar American Rail Holdings, Inc. – Control – Iowa, Chicago & Eastern Railroad Corporation*, Finance Docket No. 34178 ("DM&E/IC&E").

[18] *Dakota, Minnesota & Eastern Railroad Corporation and Cedar American Rail Holdings, Inc. – Control – Iowa, Chicago & Eastern Railroad Corporation*, Finance Docket No. 34178 (served Feb. 3, 2003), slip op. at 18-19 ("[O]ur policy has long been to encourage private sector dispute resolution whenever possible," *citing Canadian National Ry., Grand Trunk Corp. & Grand Trunk Western R.R. – Control – Illinois Central Corp., Illinois Central R.R., Chicago, Central & Pacific R.R. & Cedar River R.R.*, STB Finance Docket No. 33556 (STB served May 25, 1999) ("*CN/IC*"), slip op. at 53; and *San Jacinto Rail Ltd. – Construction Exemption*, STB Finance Docket No. 34079 (STB served July 19, 2002), slip op. at 6 n.5.)

KCS is prepared to negotiate (or more accurately, renegotiate) an agreement with UP as long as such an agreement benefits both sides, but even absent a new agreement, the Board need not be involved. UP will continue to have the protection of the existing agreements that have worked for over fifty years.

In the end, there is no need to impose any condition regarding KCS's plans with respect to future operations over the Laredo Bridge. UP has not established that KCS's control of Tex Mex will result in anticompetitive actions at the Laredo Bridge or that such harms are both substantial and likely. Indeed, there will be no harm. The existing agreements are more than adequate to protect competition and have worked well for many years. Bridge operations have improved significantly in recent years under those very agreements and are expected to improve in the future. As DOT has suggested, rather than intervening in the marketplace, if there is any concern, which there should not be, the Board, at most, should monitor the situation under its oversight authority. If a problem arises, the Board can seek a solution that addresses that particular issue, rather than accepting UP's invitation to formulate a global solution to problems that don't exist.

II. NO PARTY HAS ESTABLISHED THAT THE BOARD NEEDS TO IMPOSE A CONDITION REQUIRING KCS TO CONTINUE TO INTERCHANGE WITH BNSF AT ROBSTOWN

BNSF was involved actively throughout the earlier phase of this proceeding. BNSF was concerned that KCS would use its control of Tex Mex to "close" the Robstown interchange with BNSF and thereby BNSF would no longer be able to provide their shippers with prices to Mexico and a connection with TFM via the Laredo gateway. To ensure BNSF's access to TFM at Laredo, BNSF and Tex Mex had entered into a joint rate agreement that set the divisions applicable to a BNSF/Tex Mex routing. That agreement was originally set to expire on

December 31, 2003, but with KCS's knowledge the agreement was extended for one year and is currently set to expire on December 31, 2004. Consistent with its commitments throughout this proceeding and without conceding that BNSF's concerns required imposition of a condition at the STB, KCS agreed to sit down with BNSF to discuss their concerns. KCS and BNSF have reached an agreement that KCS believes resolves BNSF's concerns. As a result, BNSF did not file supplemental comments on September 30th.

Because BNSF did not file supplemental comments or withdraw from the proceeding, it is unclear whether BNSF continues to support the notion that KCS should freeze the existing division agreement in place for five years[19] or whether it continues to have concerns over its interchange with Tex Mex at Robstown. DOT did submit additional comments expressing some concern[20] over BNSF's continued ability to interchange with Tex Mex at Robstown; however, DOT did not support a request for a rate freeze or forced negotiations over future rate and division agreements. In the end, neither BNSF nor DOT presented any evidence of anticompetitive harm that is both substantial and likely so as to warrant imposition of a condition. As KCS has said throughout this proceeding, KCS will use its control of Tex Mex to continue to interchange with BNSF at Robstown, and Mr. Davies reaffirms that commitment. Supplemental V.S. Davies at 60. As he reiterates, KCS has no intention of not interchanging

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[19] Though BNSF prefers to use the term "rate" freeze, which implies rates to shippers, it is in fact asking to cap the divisions of Tex Mex (and TFM), while remaining free to increase its own divisions to whatever level the market will bear. *See* BNSF-5 at 16 ("During the transition period, NAFTA Rail should maintain existing divisions and rates at its gateways, except for increases no greater than increases in the RCAF-U.")

[20] "Concern" may be too strong a word as the Department's comments state that in 2003 it identified a competitive "issue," rather than a "problem" or "concern." *See* DOT Supplemental Comments (DOT-7) at 6-7.

with BNSF at Robstown. Market conditions, along with the NITL Agreement, dictate that KCS continue to work with BNSF and it will do so. *Id*

A. <u>Market Conditions Will Require KCS To Continue An Interchange With BNSF At Robstown</u>

The reasons the market will not allow KCS to raise prices to BNSF shippers or to foreclose efficient BNSF routings into and out of Mexico via the Robstown interchange were extensively set forth in KCS-18A/TM-17A at 44-80 and KCS-18B/TM-17B, V.S. Kleit at 31-38; V.S. Davies at 9-27. As set forth therein, there are several reasons for this conclusion. First, because BNSF's market reach is much broader than KCS's and because there are relatively few places where only KCS and BNSF compete head to head, there is no prospect for a commonly-controlled KCS/Tex Mex to gain market share through anticompetitive actions against BNSF interline traffic at Robstown. Supplemental Verified Statement of Dr. Curtis Grimm attached hereto as Exhibit C ("Supplemental V.S. Grimm") at 82-84. BNSF's market reach, with over 33,000 miles of track operated,[21] is more than 10 times that of KCS. With respect to traffic moving over Laredo, BNSF serves 113 markets[22] that are destinations for northbound cars (compared to 15 for KCS) and 366 markets that originate southbound cars (compared to 62 for KCS). BNSF is the sole rail service to 84 markets receiving northbound traffic and to 296 of the markets originating southbound traffic. By comparison, KCS is the sole rail service in only 11 destination markets and 46 origin markets. KCS-18B/TM-17B, Rebuttal Verified Statement of Bengt Mutén (Tab G) at 7.

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[21] http://www.bnsf.com/media/html/company_profile.html.

[22] Defined by 6-digit SPLC.

BNSF's large geographic scope in comparison to KCS makes it an important interline partner for Tex Mex. As one would expect given BNSF's large scope, traffic interchanged with BNSF accounts for a larger part of Tex Mex's traffic than does traffic interchanged with KCS. KCS-3/TM-3 at 90. Tex Mex needs the revenues from interlining with BNSF. In short, BNSF reaches many more places than KCS, giving BNSF vastly greater drawing power than KCS has for moving traffic over Laredo. A strategy that would cut off traffic interlined with BNSF or divert it to other gateways would be directly contrary to Tex Mex's and KCS's financial interests.

Second, just as important as BNSF's market reach is the fact that BNSF has the ability to use alternate gateways into Mexico. While KCS/Tex Mex has direct access to only the Laredo gateway, BNSF has direct access, via its own lines or via trackage rights, to Brownsville, Eagle Pass, and El Paso, and BNSF's own internal documents show that they have both the ability and the incentives to use these other gateways. BNSF moves more traffic via interchange with Ferromex than it does via interchange with TFM, and BNSF has increased its Brownsville traffic 250% over the 1996-2002 time periods. *See* BNSF-4 at 8; KCS-18A/TM-17A at 67-71. As a result, KCS has absolutely no incentives to raise prices or reduce service for BNSF traffic. If it did so, traffic that is routed BNSF/TM/TFM would simply switch to other gateways. Accordingly, KCS has every incentive to continue to work with BNSF to increase BNSF's share of the market.

Third, almost all of the rail traffic flowing into and out of Mexico is easily susceptible to diversion to trucks, water, or air cargo at the slightest increase in price or reduction in service. Indeed, UP's and BNSF's documents show that they view their major competitors as trucks and water, not KCS. Trucks and other non-rail modes carry nearly 90% of the cross-border traffic.

Given this pervasive modal competition, it would be contrary to KCS's economic interests to attempt to raise rates to shippers or raise division levels beyond commercially reasonable levels.

The foregoing facts show that a strategy by KCS to foreclose BNSF competitively at Robstown would be self-defeating. BNSF serves a huge number of markets that KCSR does not serve. BNSF has direct access to alternative gateways that would allow it to divert traffic to alternative routes if KCS operated Tex Mex in an anticompetitive fashion. Additionally, given the pervasive competition from trucks and water carriers, any actions KCS would take to raise rates to shippers or foreclose efficient BNSF routings would cause the vast majority of traffic served by BNSF and Tex Mex to be diverted to these other modes. Thus, even if KCS wanted to foreclose competitively BNSF at Robstown, it would simply lose traffic and revenue by doing so.[23]

B. <u>DOT's Issue Does Not Warrant A Condition</u>

As noted, because of its settlement with KCS, BNSF has not reiterated its request for a rate freeze or a condition requiring KCS to negotiate a new divisions agreement, or to have one imposed by the Board if the parties do not agree. DOT, on the other hand, has submitted comments expressing some concern over a continued BNSF/Tex Mex interchange at Robstown, although DOT does not support a rate freeze or government imposed rate negotiations.[24] While

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[23] KCS's own confidential internal documents, attached to the Supplemental Verified Statement of Mr. Davies as Exhibits 1 and 2, show that consistent with KCS's public statements, KCS has plans to work with BNSF to create a stronger competitive alternative to UP's market dominance at Laredo, not foreclose efficient BNSF routes at Robstown. *See* KCS-HC-4910 stating that KCS needs to

" KCS-HC-4876-4877 shows projected BNSF traffic moving via interchange with Tex Mex as

[24] At the time it filed its September 30, 2004 additional comments, DOT did know that KCS and BNSF had reached an agreement regarding BNSF's concerns. Given DOT's long standing

it is not entirely clear, DOT appears to be concerned that KCS may somehow foreclose BNSF from the market and that such foreclosure would be contrary to this Board's directives in the UP/SP proceeding. DOT's concerns are puzzling because they contradict DOT's own arguments that end-to-end transactions will not vertically foreclose efficient interline routings. As DOT itself said, pointing to the BN/Santa Fe merger decision,[25] "In the cases noted therein and in subsequent proceedings the agency consistently found that there would be no reduction in competition caused by vertical foreclosure." DOT-4 at 12. Further, DOT said, "We continue to believe that the [one lump] theory is valid with regard to the effects on competition of the prospective acquisition of TFM, and by extension to potential vertical foreclosure issues in the Tex Mex transaction." *Id.* at 13.

Ultimately, however, the Board should conclude that DOT's concerns over the continuation of BNSF's interchange over Robstown are misplaced. KCS has committed to continuing to interchange with BNSF at Robstown, both at the Board's July 31, 2003 hearing and in the KCS-NITL Agreement. Even without these commitments, Tex Mex's need for the revenues from the BNSF traffic, plus the market reach and competing gateway alternatives of BNSF, would make continuing to work with BNSF a practical necessity. KCS's own internal documents show that it will continue to work with BNSF and that a KCS-controlled Tex Mex expects traffic flows with BNSF to increase, not decline. Supplemental V.S. Davies at 60.

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preference for privately negotiated settlements, it is unclear whether or not DOT would have reiterated its concerns regarding the Robstown interchange if it had known about the settlement between KCS and BNSF.

[25] *See* DOT-4 at 12, *citing Burlington Northern, Inc. and Burlington Northern Railroad Company—Control and Merger—Santa Fe Pacific Corporation and The Atchison, Topeka and Santa Fe Railway Company*, Finance Docket No. 32549 (served Aug. 23, 1995).

III. THE BOARD SHOULD NOT IMPOSE CONDITIONS WITH RESPECT TO THE KCS/TFM TRANSACTION

Even though all parties admit that the KCS/TFM transaction is not before the Board for approval and is not subject to the Board's jurisdiction, UP (and CP, which relies upon UP for its Mexican market traffic) filed supplemental comments reiterating their request that the Board impose a condition to prevent anticompetitive effects allegedly arising *not* from the Tex Mex transaction, but from KCS's proposal to acquire control of TFM. Both UP and CP request that the Board impose a condition requiring KCS to negotiate concrete agreements requiring KCS to use its control of TFM to require TFM to implement "commercially reasonable terms" for UP-TFM interline movements. Absent the ability to reach such an agreement, both UP and CP want the Board to <u>impose</u> such an agreement. As justification for such a highly intrusive and broad condition, UP and CP claim that the condition is necessary to "preserve effective rail competition" (CP Supplemental Comments - CPR-5 - at 1) and to "prevent KCS's control of TFM from interfering with shippers' access to efficient and competitively priced UP-TFM interline transportation via the vital Laredo Gateway." UP Supplemental Comments (UP-11) at 4.

UP's and CP's request that the Board stand ready to impose a rate and service agreement between two interlining carriers, one of which is not even subject to the Board's jurisdiction, should be flatly rejected. First, the Board simply does not have the legal authority to impose a rate agreement that would govern an international joint-line move, and neither UP or CP have established that it does. Second, even if the Board had such legal authority, no party has shown that KCS's acquisition of TFM would have anticompetitive effects, an essential predicate for the imposition of a condition. Finally, even if that predicate had been established, the condition suggested by UP and CP is overly broad, contrary to STB precedent and policy, and would interfere with the marketplace.

A. Conditions Suggested To Regulate TFM Rates or Divisions Are Beyond The Jurisdiction Of This Agency And Cannot Be Imposed Legally

UP and CP would have the Board require KCS to enter into forced negotiations over divisions - *i.e.* how railroads divide the rate charged for a joint-line move - that TFM would charge in Mexico for its participation in an international through movement. If UP nor CP was not satisfied with the 'commercial reasonableness' (which neither party defines and which apparently means whatever UP or CP believes TFM should charge) of the divisions sought by TFM, UP and CP want the Board to impose the divisions that would be charged by TFM in Mexico. The Board should not be misled by UP's and CP's efforts to have this Board regulate, either directly or indirectly, TFM's charges in Mexico for participation in an international through movement. To do so would exceed the Board's jurisdiction and would be contrary to long-standing precedent.

TFM operates wholly within Mexico. It is therefore excluded from the Board's jurisdiction by 49 U.S.C. §10501(a)(2), which limits the Board's authority "to transportation in the United States." TFM does not provide "transportation in the United States." Moreover, TFM is not a party to this proceeding, and it is not asking for any relief or approval from the Board in this matter. TFM is not an applicant or an applicant carrier, and all parties agree that KCS's acquisition of TFM is not subject to approval by this Board. Likewise, simply because TFM participates in joint-line moves with U.S.-domiciled carriers does not bring TFM within the jurisdiction of this Board. *See Canadian Pac. Ltd. v. United States,* 379 F. Supp. 128, 134 (D.D.C. 1974) (*"Canadian Pacific"*) ("Canadian or Mexican carriers file with us, if they so desire, the tariffs establishing joint rates with our domestic carriers, and we do not thereby obtain jurisdiction over those foreign carriers.")(internal citations omitted).

UP and CP cite absolutely no authority, nor can they, for their novel position that this agency has the power to require a U.S. carrier to establish specified rates or divisions charged, not by it, but in a foreign country by its majority-owned foreign subsidiary. It is not surprising that neither UP nor CP could cite any authority for their novel position because what authority there is flatly contradicts the notion that the STB can order a foreign-based carrier, even if owned by a U.S. carrier, to establish rates or divisions in a foreign country to assure that U.S. carriers have "commercially reasonable rates." *See George C. Anspach Company, Ltd., et al. v. Atchison, Topeka & Santa Fe Railway Company, et al.*, 311 I.C.C. 296, 298 (1960)(holding that the Commission could only prescribe new rates for rail lines with domestic destinations even if the railroad was charging unlawful rates abroad); *H.K. Porter Co. v. Central Vermont Ry.*, 366 U.S. 272, 274-275 (1961)(holding that the Commission can review the reasonableness of an international through rate but only has the power to impose domestic rates); *Anglo-Canadian Pulp and Paper Mills, Ltd., et al. v. Aberdeen and Rockfish R.R. Co., et al.*, 351 I.C.C. 325, 1975 ICC LEXIS 5 at *70 (1965)("[T]o the extent complainants seek an order directed against carriers transporting newsprint solely in Canada under the involved joint international rate, their request is too broad"); *Canadian Pacific* at 134 ("[A]s in Canada Packers, the Court implied that the Commission's remedial powers cannot extend to direct control of the Canadian part of the transportation."); and *id.* at 133 n. 11 ("[I]t is well established that the Commission does not have the power to prescribe joint international rates, as it does domestic rates."). These authorities make it clear that the Board does not have the legal authority to do what UP and CP ask.

UP does attempt to justify its extraordinary request by pointing to precedent where the Board required a carrier subject to the agency's jurisdiction to alleviate anticompetitive effects of a transaction before the Board by negotiating an agreement or having the Board impose one. *See* UP Supplemental Comments at 17, n. 26, citing the Conrail transaction. That precedent is not analogous to the factual situation presented by the KCS/TFM transaction, however. In the Conrail case and other cases, the anticompetitive effect being remedied resulted from actions by a carrier subject to the Board's jurisdiction in a transaction subject to Board approval. Moreover, the agreement imposed governed domestic, not foreign rates and movements. The KCS/TFM transaction is distinguishable from UP's proffered precedent in each of these crucial respects.

UP and CP would like this Board to ignore its precedents and ignore the reality of international borders. Indeed, regardless of who owns TFM, TFM could today (absent its contractual obligations or limitations imposed by Mexican law) triple its division requirements, refuse to interline at all with any U.S.-based carrier, or refuse to provide car interchange, and the STB would have no legal authority to order them to do otherwise. This agency simply cannot require foreign-based rail carriers to enter into joint rates for international transportation or force such carriers to take any actions. *See Changes in Routing Provisions-Conrail-Western Ry. Co.-Petition to Impose Surcharge for Conrail*, 365 I.C.C. 753, 766 (1982):[26]

> It is well established that we lack jurisdiction to compel Canadian carriers to participate in joint rates to the extent that they perform the transportation outside the United States. Indeed, we may not lawfully take any punitive actions against Canadian carriers for acts that take place outside United States territory. (Internal citations omitted.)

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[26] *Accord e.g., H.K. Porter Co. v. Central Vermont Ry., Inc*, 366 U.S. 272 (1961); *Lewis-Simas-Jones Co. v. Southern Pac. R.R. Co.*, 283 U.S. 654, 660 (1931); *Fruit Importers v. Atlantic Coast Line R. Co.*, 188 I.C.C. 520, 523 (1932); *International Nickel Co. v. Director General*, 66 I.C.C. 627 (1922).

This and other legal barriers don't just magically disappear because a U.S. carrier buys a foreign railroad that operates solely in a foreign country. The Board's authorizing statute and substantial precedent thereunder prevent the Board from doing what UP and CP want this agency to do. Accordingly, the Board should reject UP's and CP's requests as being beyond the Board's authority.

B. No Party Has Established That the KCS/TFM Transaction Would Have Anticompetitive Effects Requiring A Condition

Even if one assumed that the Board has the legal authority to impose a condition arising from KCS's acquisition of TFM, the fundamental premise of UP's and CP's request for imposition of a condition, and indeed a necessary legal predicate, is that KCS's acquisition of TFM will have anticompetitive effects that are both "likely" and "substantial." *See* Section I.B, *supra*. No party has established that either of these two end-to-end transactions will have anticompetitive effects or will, as UP claims, "interfere with shippers' access to efficient and competitively-priced UP-TFM interline transportation via the vital Laredo Gateway." UP Supplemental Comments (UP-11) at 4. End-to-end transactions simply do not provide the combining companies with an opportunity to raise rates to shippers or to unlawfully foreclose connecting carriers, particularly carriers such as UP and BNSF which, because of their size and reach, possess massive competitive leverage against carriers such as KCS.

Even DOT has acknowledged that each of the two transactions presents a "classic end-to-end combination of railroads; [and] as such it neither offers great public benefits nor threatens significant public harm." DOT's Supplemental Comments (DOT-7) at 2. *See also* DOT-4 at 10-11. As DOT explained in DOT-4, the types of effects UP and a few others have argued as arising from the potential KCS/TFM transaction are issues of vertical foreclosure, and the ICC and STB have consistently found, over a twenty-year period, that "there would be no reduction in competition caused by vertical foreclosure." *Id.* at 12. DOT, in its thorough recitation of the Board's vertical foreclosure theory, makes it clear that the KCS/TFM transaction "merely shifts the market power organizationally to NAFTA Rail" and that "market forces will not permit rates [to shippers] to be raised post-merger" and "[c]ompetition, therefore, will not be reduced by the merger." *Id.* at 13. According to DOT, "[I]t is logical from a profit maximization standpoint for a vertically integrated railroad such as NAFTA Rail not to 'foreclose' unaffiliated railroads, UP in this case, from participating in more efficient routings to and from points in the U.S." *Id.* at 13. DOT also states that it "continue[s] to believe that the theory is valid with regard to the effects on competition of the prospective acquisition of TFM, and by extension to potential vertical foreclosure issues in the Tex Mex transaction." *Id.*

DOT's conclusions have also been shared by other governmental agencies. Every governmental agency that has reviewed the transactions, including the Mexican Federal Competition Commission, the U.S. Department of Justice, and the U.S. Department of Agriculture, has come to the same conclusion --the KCS/Tex Mex/TFM transaction will not reduce competition. Nothing has been presented in this proceeding that should lead the STB to reach a different conclusion.

The evidence submitted to try to persuade the Board to reach a conclusion opposite that of the other agencies is unpersuasive. UP submitted testimony by Dr. Hausman and Mr. Gray, attempting to show that the KCS/TFM transaction is somehow so unique that the Board should ignore its 20 years of precedent regarding the benign effects of an end-to-end transaction (much of it premised upon UP's own testimony regarding the benign effects of its own mergers), as well as its lack of legal authority, and nonetheless impose a condition regulating TFM's rates, divisions, and services. The Board should not do so.

Dr. Andrew Kleit, economics professor from Pennsylvania State University, and Gerald Davies who, in addition to being KCS's Executive Vice President and Chief Operating Officer, holds a doctorate in transportation economics, have shown why the assumptions underlying Dr. Hausman's and Mr. Gray's theories have no relationship to actual market conditions or to the Mexican regulatory scheme. Dr. Kleit showed that the Board's precedents and theories regarding vertical foreclosure in an end-to-end transaction remain valid in the context of the proposed KCS/TM and KCS/TFM transactions. *See* KCS-18A/TM-17A at 30-44, KCS-18B/TM-17B, Tab E, Kleit at 9-17. He also made clear that the harms alleged by UP are not potential increases in rates to shippers, but rather are concerns over how the various interline rail partners divide the profit. In other words, UP's opposition is really a fight to protect UP's leverage regarding divisions, not about harm to shippers. While the proposed transactions may, as DOT said, somewhat shift the relative bargaining positions of the parties with respect to each party's share of the economic rents, the transactions will not result in foreclosure of efficient interline routes or raise prices to shippers. *Id.,* Tab E, Kleit at 35-38; Tab F, Davies at 24-27.

As Dr. Kleit and Mr. Davies further explained, even if one assumed that the accepted economic theory on vertical foreclosure was somehow inapplicable to the KCS/TFM transaction, market conditions would nevertheless still prevent KCS from raising rates to shippers or foreclosing UP and BNSF from the Mexican market. First, UP, CP, and BNSF provide a significant amount of traffic to TFM today. Indeed, they account for well over 90% of the traffic interchanged from TFM at Laredo. It would be unprofitable for KCS to use its control of TFM to take actions that would foreclose this traffic.[27] Second, if TFM, under KCS control, were to

[27] As Mr. Davies pointed out, supported by the data from Mr. Bengt Mutén, KCS-18B/TM-17B, Tab G, there is a minuscule number of points where KCS competes against UP or BNSF for

raise its division requirements to levels unacceptable to UP or BNSF, these carriers would simply shift their traffic to the other gateways.[28] Third, the demand characteristics of almost all of the rail traffic flowing into and out of Mexico is elastic in nature, and the traffic is easily susceptible to diversion to trucks, water, or air cargo at even a slight increase in price or reduction in service.[29] Fourth, to the extent the traffic is inelastic, *i.e.* rail dependent, the rate to the shipper is already as high as it can go for there is only "one lump" available to the carriers. If TFM is not taking that "one lump," then certainly UP is. As a result, the proposed transactions will not enable the railroads to raise prices to shippers in a post-transaction environment. KCS-18A/TM-17A at 30-44; KCS-18B/TM-17B, Kleit, Tab E, at 9-16.[30] Finally, because most of the traffic is already "locked-in" via contracts and there is limited (and mostly UP-controlled) capacity over Tex Mex's route, KCS's ability to use TFM to attempt to force traffic over the

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Mexican traffic and a substantial amount of TFM's traffic comes from UP and BNSF exclusively-served points. It is counter to economic logic for KCS to take actions with respect to TFM that would price this traffic out of the market.

[28] UP has access to six other gateways and BNSF to four. UP's and BNSF's own documents, obtained in discovery and discussed in KCS-18A/TM-17A at 66-74, establish that both of these carriers view the other gateways as viable alternatives to Laredo. Both carriers have previously threatened to use those alternative gateways if TFM or Tex Mex's divisions were not reasonable. BNSF has in the past shifted traffic to other gateways in response to Tex Mex service issues.

[29] Indeed, UP's and BNSF's documents show that they view their major competitors as trucks and water, not KCS. Indeed, trucks and other non-rail modes carry nearly 90% of the cross-border traffic. Given this pervasive modal competition, it would be contrary to KCS's economic interests to attempt to raise rates to shippers or raise division levels beyond commercially reasonable levels. KCS-18A/TM-17A at 58-66.

[30] Furthermore, to the extent neither carrier is taking the "lump," that is due to other market forces, and the transactions will not change those forces. KCS-18A/TM-17A at 36-38. More likely, however, because of UP's extensive access to exclusively-served points in the U.S., its numerous Mexican gateways, its long-term contracts, and its market share, UP is the bottleneck carrier who is extracting the "lump," not TFM.

KCS/Tex Mex system is extremely limited. KCS-18A/TM-17A at 74-79; Supplemental V.S. Davies, Exhibit A hereto, at 61.

Dr. Curtis Grimm, who has a long history of writing and speaking about vertical foreclosure issues, has also reviewed these transactions and determined that neither the KCS/TM transaction nor the KCS/TFM transaction will have anticompetitive effects so as to warrant imposition of a condition. While his primary focus, like the Board's historic focus, was on the horizontal aspects of the proposed transactions, he also testified that vertical foreclosure is not a concern in these transactions. KCS-18B/TM-17B, Rebuttal Verified Statement of Dr. Curtis Grimm, Tab B at 4 ("I fully concur with his [Dr. Kleit's] finding that there will not be anticompetitive effects from vertical foreclosure in this case.").

Dr. Grimm reiterates his findings with respect to the competitive issues in this proceeding in his attached Supplemental Verified Statement. Inasmuch as Dr. Grimm's research has often led him to be cautious regarding the Board's conclusions about vertical foreclosure and the benign effects of end-to-end transactions, it is noteworthy that he has examined the vertical foreclosure issues in both the KCS/TM and KCS/TFM transactions and has concluded that neither transaction "will result in increased prices to shippers or the inefficient foreclosure of UP/TFM or BNSF/TM/TFM routings." Supplemental V.S. Grimm at 87. His opinion confirms that "market conditions are sufficient to prevent either transaction from having anticompetitive effects." *Id.*

No party other than UP submitted expert testimony supporting the notion that the KCS/TM or KCS/TFM transactions would have anticompetitive effects. A few shippers not served directly by KCS expressed concern that the transaction would harm them, not because their rates would go up, but because it would allow KCS to better serve their competitors who are shippers on KCS lines. These concerns were addressed at KCS-18A/TM-17A at 88-93. Of course to the extent the transactions do allow KCS to lower rates to shippers located on its lines or to increase its efficiency so as to make it more economical for these shippers to ship to Mexico, that is a pro-competitive effect.

The only purchaser of rail service to even remotely support UP's requested condition was Pacer. Pacer, which operates "Pacer Stacktrain," buys rail capacity and then resells that capacity to intermodal marketing companies, actually competing against rail carriers for intermodal business. Pacer's largest domestic rail partner is UP, so it should be no surprise that Pacer has previously supported UP's efforts in this proceeding. Notably, though, Pacer chose not to file supplemental comments on September 30. Pacer's filings and testimony do not establish that the KCS/TFM transaction would be anticompetitive so as to warrant a condition. *See* KCS-18A/TM-17A at 83-87.

Although none of the comments filed by DOT, UP, BNSF, CP, or Pacer support the notion that the transactions, whether viewed independently or together, justify imposition of UP's or CP's suggested condition regarding the Laredo gateway, UP does make one final attempt to justify its request for conditions. In its Supplemental Comments (UP-11) at 14, UP contends that its proposed condition is needed to effectuate this agency's action in *UP/SP*, when this agency granted Tex Mex trackage rights to connect with KCSR at Beaumont to preserve competition at Laredo.

It is true that in *UP/SP* the Board granted Tex Mex trackage rights over UP to preserve rail-to-rail competition north of the border. These rights were necessary because prior to the UP/SP merger, there were two independent routes north of the border to Laredo – a UP route and an SP/Tex Mex route. Absent Tex Mex's trackage rights, UP would have controlled all of the routes into and out of Laredo. The trackage rights preserved competing routes to and from Laredo. However, the issues in *UP/SP* are not analogous to the KCS/TM or KCS/TFM transaction. *UP/SP* involved issues of a loss of horizontal competition while this proceeding involves alleged vertical competitive effects. Nothing in the KCS/TFM transaction causes a loss of horizontal competition north of the border or undermines the Board's goal of having rail-to-rail competition to the Laredo gateway. UP will remain an independent carrier able to price its services and rates north of the border how it best sees fit as will KCS. In fact, KCS's control of its end-to-end connection will not extinguish this competition to Laredo, but rather will enhance the ability of KCS and BNSF to compete against UP.

In the end, the record in this proceeding shows that KCS's control of Tex Mex will have absolutely no anticompetitive effects that would warrant the imposition of any conditions. This conclusion does not change when one considers the effects of the KCS/TFM transaction. This conclusion is widely-accepted, being supported by numerous government agencies, shippers, and shortline railroads. In fact, no shipper, not even Pacer, has gone as far as to support UP's and CP's requested conditions. On the other hand, dozens and dozens of shippers support the transactions, and the nation's largest trade association representing shippers, the NITL, fully supports the transactions.

C. <u>The Conditions Suggested By UP, CP And Others Are Overly Broad And Not Narrowly Tailored</u>

1. The Suggested Conditions Go Far Beyond Merely Implementing KCS's Commitment To Keep The Laredo Gateway Open On Commercially Reasonable Terms

Even though no party has established that the Board has the legal authority to impose a condition regarding the KCS/TFM transaction or established that the transactions will have anticompetitive effects justifying imposition of a condition, DOT, UP, and CP nonetheless each request imposition of a condition regarding the Laredo gateway. DOT wants the Board to require "KCS to adhere to its commitments on this issue" and "establish an oversight period during which parties could bring to the Board's attention evidence of merger-related harms and/or violation of relevant KCS commitments." DOT-7 at 6. CP goes further. CP wants a condition requiring KCS to abide by its commitments, but also wants the Board to require KCS "to enter into binding written agreements setting forth the terms upon which competing carriers will be able to access Laredo" and to impose the terms of such agreements if necessary. CPR-5 at 7-8. UP seeks similar relief, but goes even further, setting forth a highly complex rate and service agreement regarding CN and British Columbia Rail ("BCR") as the model for an agreement they would like to see imposed by this Board if KCS were not willing to agree with UP on what TFM's charges should be.

According to these parties, all of these suggested conditions should be imposed now in the KCS/TM transaction even though they are directed at the KCS/TFM transaction and would "spring into effect" when and if KCS is able to acquire control of TFM. *See* UP-11 at 16. Assuming all of the legal predicates for imposition of conditions had been met, which they have not, these conditions should nonetheless still be rejected as unnecessary, and in the case of UP and CP, overly broad.

All of these parties attempt to couch their requests as merely implementing KCS's commitment to keep the Laredo gateway open on commercially reasonable terms. However, UP and CP in reality are not pursuing the spirit of KCS's commitment but are instead distorting it to focus on protection of their divisions, not on protection of the shippers for whom the commitment is intended. Almost from the day the two proposed transactions were announced, KCS assured parties that it would keep the Laredo gateway open and work to improve service.

These commitments were given to assure the shippers that as a result of KCS control of Tex Mex and TFM, their rail rates would not increase nor their service degraded. They were not given to guarantee UP or CP their relative bargaining positions with respect to divisions between themselves and TFM, or to promise them fixed divisions or rates of return. KCS's commitment runs to the shippers over rates and service, not to competing carriers over divisions.

Indeed, to implement KCS's commitment to keep the Laredo gateway open and to preserve service, KCS entered into the NITL agreement. This agreement requires that KCS (1) offer commercially reasonable rates to shippers for traffic to/from Mexico; (2) honor all existing agreements governing rates and divisions over KCS and Tex Mex; and (3) maintain service standards. It also recognizes the sovereignty of the U.S. and Mexican governments, and covers both the KCS/TM and the KCS/TFM transactions, taking effect in pertinent part when each transaction occurs. The NITL agreement properly protects shippers' interests and concerns and is consistent with this agency's policy of favoring negotiated settlements and allowing the marketplace to govern.

UP and CP are deliberately ignoring this fundamental point. They want this Board to impose as a condition their distortion of KCS's commitment, not to protect rail rates or services to shippers, but instead to protect UP's and CP's profits and divisions, to give them "commercially reasonable rates [read 'division']," and to regulate TFM's divisions absent agreement by TFM. In other words, they want to protect competitors, not competition. As this agency has said numerous times, it is the job of the STB to protect competition, not competitors. *See* KCS-18A/TM-17A at 95-96, and cases cited therein.

While DOT supports a general condition holding KCS to its commitments, it is important to note that DOT does not support any rate freeze proposals, and does not support the conditions suggested by UP or CP. Given the NITL agreement, KCS does not believe that DOT's suggestion to impose a specific condition requiring KCS to keep the Laredo gateway on commercially reasonable terms is necessary. As KCS has said, it has no intention of closing the Laredo gateway and fully intends to maintain commercially reasonable rates for shippers for traffic to and from the Laredo gateway. However, this commitment does not mean that KCS agrees that competing carriers have a right to request this agency to impose divisions. As previously noted, KCS's commitment is directed to the shipper and its rates and services. It is not intended as consent to extension of this agency's jurisdiction to govern TFM's rates or divisions or as a waiver of KCS's rights to challenge the legal basis of any future efforts to impose rates and practices on TFM.

2. The Consent Decree Governing CN's Acquisition Of British Columbia Rail Is Not A Good Model

UP sets forth a highly regulatory and complex agreement imposed by the Canadian government in the context of CN's efforts to acquire BCR as the model for an agreement that UP would like to see KCS negotiate or the STB impose if KCS would not accede to it.[31] That agreement required BCR to adopt certain rates, divisions, and transit time guarantees which are applicable solely in Canada, but are used in conjunction with interline movements with other carriers, including U.S. carriers. That agreement does not represent a good model for use in this case.

[31] Apparently, even this highly complex agreement doesn't satisfy UP's notion of what is "commercially reasonable" as UP claims that this agreement was "not as effective as it could be at preserving pre-merger competitive options." UP Supplemental Comments (UP-11) at 21, n. 36. UP's footnote, stating its position that even this far-reaching, government-imposed agreement does not go far enough, also shows that UP is unlikely to be willing to agree with KCS on any less-intrusive solution, virtually guaranteeing that the Board would have to impose terms.

The CN/BCR model offered by UP makes clear that UP wants to have the STB impose rates, divisions, and service guarantees, not on Tex Mex or KCS, but on TFM, to govern TFM's rates and services, just like Canada did on CN's control of BCR. Yet, as previously noted, this is precisely the type of action that precedent prevents the STB from taking. In fact, the CN/BCR case actually supports the Board's precedent by showing that when a carrier subject to the jurisdiction of the STB (*e.g.*, CN) acquires a railroad operating in a foreign country (*e.g.*, BCR), it is the responsibility of the foreign government where the transaction is taking place (in that case, Canada) to review the transaction and if necessary, impose conditions to achieve its objectives. Likewise, it is the responsibility of the Mexican government, and not the STB, to review and regulate KCS's acquisition of TFM.[32]

This model also shows the fallacy of UP's argument from a legal and jurisdictional point of view. If that transaction represents the theory of what should occur, then when CN sought to acquire BCR, UP should have fought the transaction at the STB on the basis that CN's control of BCR was going to foreclose UP's access to BCR. Indeed, UP should have been at the STB requesting the STB to impose a requirement on CN (which, like KCS, is subject to the STB's jurisdiction) that CN use its control of BCR (which, like TFM, is not subject to the STB's jurisdiction) to require BCR to enter into an agreement with UP, or absent an agreement, impose such an agreement. Of course, UP did no such thing and the STB would have summarily dismissed such a request if it had received one. Likewise, the STB should not allow UP and CP

[32] In addition to the approvals required in Mexico, the U.S. DOJ will also have an opportunity to again review the competitive effects of the transaction as KCS and TMM will have to refile their notice under the Hart-Scott-Rodino Act, due to the lapse of the prior early termination notice. If there are anticompetitive effects of that transaction here in the U.S., DOJ has the authority to require KCS and TMM to enter into a "consent decree" to resolve those concerns. The STB should not attempt to preempt or interfere with that process.

to use the KCS/TM transaction as a ruse for getting the STB to impose conditions on the KCS/TFM transaction.

Legal issues aside, when one examines the competitive issues, it is clear that the CN/BCR transaction presented competitive issues completely different from those presented by the KCS/TFM transaction. Dr. Grimm addresses those issues in his Supplemental Verified Statement, Exhibit C hereto. First, there is a fundamental difference in regulatory schemes and structures. Unlike the STB, the Canadian agencies continue to play a very active role in managing the marketplace by setting rates, divisions, trackage rights fees, switching fees, and imposing mandatory competitive access. Second, the CN/BCR transaction would be like UP buying TFM, not like KCS doing so. CN originated or terminated most of BCR's traffic, as UP does with TFM. Third, in the CN/BCR transaction, there were no alternative railroads providing access to shippers in the British Columbia hinterlands. This contrasts sharply with UP's and BNSF's ability to access Mexican shippers through alternative gateways and Ferromex. Fourth, the degree of intermodal competition varies between the two transactions. In other words, unlike the situation in the KCS/TFM transaction, trucks and water played a lesser role in providing a competitive check on rail rates in the CN/BCR transaction. Given all of these circumstances, the Canadian government determined that market forces would not be sufficient to prevent a combined CN/BCR from raising rates to shippers and inefficiently foreclosing other carriers from the market. Here, by contrast, the market factors are ample to constrain KCS/TFM and KCS/TM from anticompetitive behavior.

Finally, it would represent bad policy for the STB to require KCS to negotiate over the rates, divisions, and service standards to be applied by TFM and, absent agreement by KCS, to impose such an arrangement. Such a scenario has the potential to expose U.S. carriers to impermissible actions by foreign countries. One can imagine a scenario where, if the U.S., through the STB, begins to tell foreign rail subsidiaries what rates, divisions, and service standards to adopt in their own countries, these countries would presume that turnabout is fair play. When CN acquired IC, should the Canadian government have told CN what rates and services IC could charge, not in Canada, but in the U.S.? If it had, CN would have been the first to complain and the STB likely would not have recognized such an action being within Canada's jurisdiction. Likewise, if the facts in the KCS/TFM transaction were reversed and TFM were acquiring KCS, should the Mexican government be able to tell TFM what rates, services, and charges KCS should adopt in the United States? Of course not. Neither should the STB impose rates, divisions, and service standards on TFM or adopt conditions that would expose the Board to the potential risk of having to do so.

3. UP's Requests Contradict UP's Own Position In Other Proceedings, As Well As Board Policy

As noted, UP's suggested condition regarding KCS's acquisition of TFM would only "spring" into effect if KCS also acquired control of TFM.[33] Setting aside the fact that these conditions would spring into effect on a transaction that is outside the Board's jurisdiction, UP's suggestion is diametrically opposed to the position UP has taken in other matters, as well as to Board precedent.

In the past, UP has opposed the use of "springing conditions." In its comments in the Board's Major Rail Consolidation proceeding, UP urged that "[t]he Board should not attempt to remedy the effects of downstream mergers by designing conditions that would spring into effect when a downstream merger occurs." Union Pacific's Opening Comments on Proposed Merger

[33] UP's September 30 Comments (UP-11) at 15-16.

Rules, STB Ex Parte No. 582 (Sub-No. 1), filed Nov. 17, 2000 ("Opening Comments") at 5-6. "Any attempt to specify springing conditions in advance is doomed to fail," UP stated, citing the Board's "long-established policy of favoring finality in its review of merger proceedings." Union Pacific's Closing Comments on Proposed Merger Rules, STB Ex Parte No. 582 (Sub-No. 1), filed Jan. 11, 2001 at 16-18 (citing *Seaboard Coast Line R.R. – Investigation of Control & Modification of Traffic Conditions*, 360 I.C.C. 582, 606 (1979)).

The Board adopted UP's position against springing conditions as part of its major rail consolidation rules. The Board specifically accepted UP's position that the use of "springing" conditions was likely to "undermine the predictability and finality that carriers need to have in order to consummate any merger transaction." *Major Rail Consolidation Procedures*, STB Ex Parte No. 582 (Sub-No. 1), 2001 STB LEXIS 546 (served June 11, 2001) ("*Ex Parte No. 582*"), at *100-*101, and that "we will not be able to specify, in the final decision approving a merger, the conditions that will 'spring' into effect when a downstream merger occurs." *Ex Parte No. 582* at *433-*434.

The citations in UP's Supplemental Comments for the proposition that "springing" conditions are "nothing unusual"[34] are highly misleading. UP's proposed springing condition in this case would attempt to resolve a problem that does not now, and may never, exist. That is vastly different from the Board having continuing jurisdiction to examine and resolve a problem that arose from a Board-approved merger by imposing a specific condition to address the specific problem. Furthermore, UP's suggested CN/BCR solution is unlike the requirement that applicants in major mergers "suggest additional measures that the Board might take if it approves the application and the anticipated public benefits identified by the applicants fail to

[34] UP September 30 Comments (UP-11) at 16, n. 22.

materialize," because that requirement also contemplates that a known problem will be examined and resolved. By contrast, UP's proposed CN/BCR condition would impose a solution without knowing whether a problem will even exist. Moreover, the triggering event for UP's proposed springing condition - the mere occurrence of KCS control of TFM - is not a competitive problem at all; rather, it is transaction that has already passed muster with competition authorities in the U.S. and Mexico.

UP's request for a springing condition contradicts the position UP has taken in the past, and seeks to remedy a "problem" that does not now and very likely never will exist. Rather than accepting UP's suggestion, the Board should adhere to the maxim that it "is not required to act as a roving ombudsman restructuring railroads on its own in order to satisfy an individual carrier's notion of what effective competition may require." *Southern Pacific Trans. Co. v. Interstate Commerce Commission*, 736 F.2d 708, 722 (D.C. Cir. 1984), *cert. denied* 469 U.S. 1208 (1985) (upholding denial of conditions requested to "ensure effective competition" because they were not designed to mitigate anti-competitive consequences stemming directly from the transaction before the agency).

CONCLUSION

Quite simply, the issue before the Board is whether opponents of KCS's control of Tex Mex have shown a likelihood of substantial competitive harm arising from that transaction. Clearly, they have not. In fact, no party openly opposes the transaction. Instead, a wide array of shippers and even other government agencies whole-heartedly support the transaction. These parties include the U.S. Department of Agriculture ("USDA"), which almost universally opposes further rail system consolidation. Even USDA says that KCS's control of Tex Mex, and of TFM, will strengthen, not reduce, competition. That conclusion is in harmony with the conclusions of all of the other agencies that have reviewed these transactions, namely the Mexican Federal Competition Commission, the Mexican Foreign Investment Commission, and the United States Department of Justice.

Nevertheless, a few of KCS's competitors and their allies seek to improve their hold on the market by alleging theoretical anticompetitive strategies KCS might employ and suggesting, as remedies to those theories, conditions that would impede open competition, continue UP's market dominance, and likely even impair rail-to-rail competition in Mexico. KCS, on the other hand, has affirmatively shown that this transaction, even if considered in the context of the proposed TFM transaction, will not have any anticompetitive effects. There are no horizontal competitive effects of this purely end-to-end transaction nor is there harm to source competition. Neither are there anticompetitive vertical foreclosure effects under the Board's long-standing, widely-accepted merger theory, which DOT reiterates and endorses. Although expressing some lingering concerns, even DOT finds that the transactions will not result in vertical foreclosure.

Even if vertical effects were possible in theory, economic necessity created by the market reach of UP and BNSF is so great that none of the theoretical effects could come into play. Economists Andrew Kleit and Curtis Grimm each demonstrate that vertical effects do not exist, a particularly telling position from Dr. Grimm who believes competitive effects are possible in end-to-end transactions. The contrary conclusions previously offered by Dr. Hausman and Mr. Gray are based on flawed assumptions, as explained at length in the KCS-18/TM-17 last September.

Even the limited opposition originally voiced to KCS's control of Tex Mex has subsided over the past year. Pacer sought a variety of Board actions last year. This year, with its concern over the implementation of MCS addressed, it has not renewed its requests. Last year, BNSF sought to extend its five-year divisions agreement with Tex Mex through a Board-imposed freeze on Tex Mex and TFM divisions, but, having had its agreement with Tex Mex extended at least through December 2004 and having discussed matters with KCS, BNSF did not now renew its requests for protection. Similarly, the past year has shown that concerns voiced by NS about investment in KCS's Meridian Speedway and UP's concerns about fluidity of operations at the Laredo Bridge have not been borne out.

KCS has stated firmly on the record in this case that offering competitive and improved service is the goal of NAFTA Rail. Unless KCS, as NAFTA Rail, offers improved service and rates, traffic will be lost to other carriers through other gateways or to the dominant cross-border mode – trucks and water carriage. Competing, not stifling competition, is the objective of NAFTA Rail. While KCS understands that its competitors do not want to lose any of their overwhelming competitive leverage, KCS submits that competitive leverage is not the Board's proper concern. The carriers will work out whatever differences they may have while continuing to provide improved service offerings to shippers, because that is what the marketplace demands.

The simple fact is that the transaction before the Board, even in the context of the proposed but still uncertain TFM transaction, does not have any anticompetitive effects. No one has shown the contrary. Under Section 11324(d), that fact calls for granting KCS's application unconditionally. In so doing, the Board will be allowing the marketplace to govern subject to the Board's continuing oversight to review potential problems in the future.

Furthermore, given the delays in the transaction from last year and the fact that Tex Mex is currently being run under a voting trust, KCS renews its request that the Board make its decision in this case effective no later than 5 days from issuance of its decision. S*ee* KCS/Tex Mex May 14, 2003 Petition To Establish Procedural Schedule at 6, n. 4. This is consistent with numerous precedents for minor transactions. In doing so, Tex Mex will be released from the constraints associated with operating of a voting trust, which somewhat limits its ability to make long term plans and enter into long term rate agreements. Likewise, KCS can move forward as expeditiously as possible in putting its larger resources to work for a struggling Tex Mex.

Respectfully submitted,

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October 15, 2004

BEFORE THE
SURFACE TRANSPORTATION BOARD

FINANCE DOCKET NO. 34342

KANSAS CITY SOUTHERN

- CONTROL -

THE KANSAS CITY SOUTHERN RAILWAY COMPANY,
GATEWAY EASTERN RAILWAY COMPANY,
And
THE TEXAS MEXICAN RAILWAY COMPANY

REPLY OF KANSAS CITY SOUTHERN, THE KANSAS CITY SOUTHERN RAILWAY COMPANY, GATEWAY EASTERN RAILWAY COMPANY,
And
THE TEXAS MEXICAN RAILWAY COMPANY
TO ADDITIONAL COMMENTS FILED SEPTEMBER 30, 2004

VERIFIED STATEMENTS

BEFORE THE
SURFACE TRANSPORTATION BOARD

FINANCE DOCKET NO. 34342

KANSAS CITY SOUTHERN

- CONTROL -

THE KANSAS CITY SOUTHERN RAILWAY COMPANY,
GATEWAY EASTERN RAILWAY COMPANY,
And
THE TEXAS MEXICAN RAILWAY COMPANY

REPLY OF KANSAS CITY SOUTHERN, THE KANSAS CITY SOUTHERN RAILWAY COMPANY, GATEWAY EASTERN RAILWAY COMPANY,
And
THE TEXAS MEXICAN RAILWAY COMPANY
TO ADDITIONAL COMMENTS FILED SEPTEMBER 30, 2004

EXHIBIT A

SUPPLEMENTAL VERIFIED STATEMENT OF GERALD K. DAVIES

BEFORE THE
SURFACE TRANSPORTATION BOARD

FINANCE DOCKET NO. 34342

SUPPLEMENTAL VERIFIED STATEMENT OF GERALD K. DAVIES

My name is Gerald K. Davies and I am the Executive Vice President and Chief Operating Officer of The Kansas City Southern Railway Company ("KCSR"). I have a PhD in transportation economics and have previously provided two written statements to the Board in this proceeding, one in KCS-10/TM-10, Supplement To Application, and the other in KCS-18B/TM-17B, Response To Comments, Protests, and Request for Conditions. I also testified at the Board's July 31, 2003 public hearing (the "Public Hearing") held in conjunction with this transaction. I do not intend to repeat all of my previous findings and arguments here. Instead, the purpose of this statement is to address some issues raised in the September 30, 2004 Additional Comments filed by Union Pacific Railroad Company ("UP"), Canadian Pacific Railroad Company ("CP), and the United States Department of Transportation ("DOT").

The Laredo Bridge

In UP's additional comments, it once again claims that the existing agreements governing dispatching and control of the northern half of the International Bridge at Laredo ("Laredo Bridge") are inadequate to prevent KCS from using its control of Tex Mex to disadvantage UP-TFM routings. UP wants the Board to impose a condition requiring KCS to negotiate a new protocol with it. UP's previous comments advocated that this protocol should require establishing a joint operations center that would "give UP a formal role in decisions about Bridge operations and priority for movements over the Bridge." UP-7A at 101. Absent KCS agreement to such a new protocol, UP asks to have such a protocol developed and imposed by the Board. UP's suggested condition is unwarranted, unnecessary, and should be rejected.

As an initial matter, UP has failed to show that the existing agreements are inadequate to protect its interests. As I understand it, the UP asserts that the agreements could be interpreted such that Tex Mex, under KCS control, could require that UP and Tex Mex each get 50% of the capacity of the bridge. In other words, if there are 24 available slots per day to run trains over the bridge, Tex Mex would get 12 and UP would get 12, even though Tex Mex has only enough trains to fill 6 slots, for example. Under UP's theory, Tex Mex would allow its other 6 slots to go unused.

There are several reasons why UP's theory is in conflict with the realities of operating the bridge. First, such an approach would be against KCS's economic interest. Obstructing UP traffic at the bridge would cost TFM revenue, which would harm our investment in TFM. The notion that KCS would adopt a policy that allows available slots on the bridge to go unused, even though there were UP trains waiting to use those slots, is just not credible. In addition, UP has a dominant market share, serves many points not served by KCS, and has many ways to retaliate against KCS.[35] It would be unprofitable not to move UP traffic if capacity were available. As I

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[35] Indeed, it is UP that has the chokehold over KCS and Tex Mex as they have absolute control over the very operations that allow KCS to connect with the Laredo Bridge, i.e. Tex Mex's trackage rights over UP between Beaumont and Robstown/Corpus Christi. In fact, data that UP submitted to the FRA in its brake waiver petition (FRA Docket No. FRA-2004-18746-1, *Union Pacific Railroad Company Request for Air Brake and Inspection Waivers*, 69 Fed. Reg. 54177, September 7, 2004) showed UP's market share over Laredo increasing 7.1% between 1999 and 2003. During that same period, Tex Mex's transit times on UP between Robstown and Beaumont roughly doubled. UP's increased market share at Laredo appears to be directly related to the operational obstacles Tex Mex experiences on UP's lines. Additionally, UP has the ability to use other gateways to Mexico, which KCS does not.

told the Board last July, there is plenty of unused capacity on the bridge, and that statement remains true today.[36]

Second, UP's argument rests on the notion that the transaction will somehow change Tex Mex's incentives with respect to UP's use of the Laredo Bridge. As Chairman Nober noted at the Public Hearing, if it were in KCS's larger interest now to raise rates, constrain UP's use, or otherwise manipulate UP's use of the bridge to try to derive more revenue for Tex Mex, the same actions would have been in Tex Mex's interest in the last several years as well, but those actions did not occur. Chairman Nober is right. It did not happen then and it will not happen in the future.

Finally, I would like to address UP's arguments regarding KCS's willingness to negotiate new protocols. KCS has always believed that the existing agreements and existing arrangements have worked well. KCS has absolutely no plans to change any of the existing practices governing the bridge. Dispatching over the bridge will continue to operate out of the UP facility in downtown Laredo and will remain subject to UP's direct involvement. There will be daily calls and monthly meetings to resolve both immediate and long term concerns. KCS intends to work with UP to increase efficiency of the operation over and the capacity of the bridge.

Nonetheless, because of UP's fears regarding the transaction and its desire to reach new protocols, KCS agreed, prior to TFM's repurchase of Mexrail's stock last year, to sit down with UP to negotiate over their concerns and issues. Our willingness to negotiate was not recognition on our part that the existing arrangements were inadequate or that new protocols were needed. In fact, the bridge is now operating better than it has in many years. We met because it is our

[36] My analysis, repeated at the Board's Public Hearing, establishes that the bridge is operating at about 50% of its capacity.

business practice to always sit down with parties with whom we have agreements to see if there are ways to work together to improve operations.

Since KCS announced the renewed agreement to acquire Mexrail, UP has not approached KCS again on new bridge protocols. The first I became aware of UP's continuing interest in negotiating new protocols was upon receiving information about UP's September 30 filing with the Board in which it requested a condition on the transaction. KCS remains willing to sit down with UP, just as we would with any party with whom we have agreements. I commit to doing so again, but as UP itself has said in the past, the Board should not involve itself in private negotiations and should not impose an agreement merely because UP and KCS are unable to agree.

<u>BNSF Interchange At Robstown</u>

KCS believes that market forces, the NITL agreement, and KCS's willingness to work with BNSF demonstrate that there is really no issue of concern regarding BNSF's ability to interchange with Tex Mex at Robstown. In fact, after discussions with KCS, BNSF chose not file comments on September 30.

BNSF was actively involved throughout the early portion of this proceeding. At that time, BNSF argued that KCS would use its control of Tex Mex to "close" the Robstown interchange, thereby depriving shippers of access to Mexico. Absent the interchange with Tex Mex at Robstown, BNSF would have access to TFM at Brownsville or could use its other gateways, mainly El Paso and Eagle Pass, thereby depriving Tex Mex and potentially TFM of revenues associated with the traffic. Cleary, BNSF has considerable leverage over both Tex Mex and TFM.

When KCS announced the renewed agreement for the Tex Mex transaction, BNSF contacted KCS and requested negotiations over their concerns about the Robstown interchange and about the existing divisions agreement. Consistent with its commitments throughout this proceeding, and without conceding that BNSF's concerns required imposition of a condition at the STB, KCS agreed to sit down with BNSF. KCS and BNSF have reached an agreement that KCS believes resolves BNSF's concerns.

While the existing Tex Mex divisions do not appear to provide Tex Mex with an adequate contribution to its costs, we know that if a KCS-controlled Tex Mex were to attempt to raise Tex Mex's divisions too high, then either BNSF would simply shift its traffic to its other gateways (which BNSF has told us that they are willing to do) or railroads would lose the traffic altogether as the shippers move to other modes. These market forces, plus the NITL agreement, show why the conditions once requested by BNSF are neither justified nor necessary. As KCS has said throughout this proceeding, a KCS controlled Tex Mex will continue to interchange with BNSF at Robstown. We have to. Market conditions require it. The NITL agreement requires it.

DOT has expressed concern that KCS might "reduce BN's role as the major competitive spur to UP in the affected region." DOT need not be concerned.[37] In fact, as shown by the attached documents prepared for KCS's executive committee, Exhibits 1 and 2, our plans are to increase our cooperation with BNSF, not reduce it.

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[37] I note that DOT has never supported BNSF's rate freeze request or a requirement that the parties negotiate a new agreement under STB oversight and have the STB impose such an agreement if the parties were unable to agree.

KCS's "Open Gateway" Commitment At Laredo

Even though all parties admit that the KCS/TFM transaction is not in front of the Board and is not subject to the Board's jurisdiction, UP and CP have filed supplemental comments reiterating their requests that the Board impose a condition arising from KCS's efforts in Mexico to acquire control of TFM. I will leave it to the lawyers to discuss whether or not such a condition would even be legal, and instead I will focus on the merits of their claims.

Market forces will simply prevent KCS from raising rates to shippers or from foreclosing efficient UP and BNSF routes to and from the Mexican market. There are several reasons for this. First, UP, CP, and BNSF provide a significant amount of traffic to TFM today. The vast majority of this traffic comes from points not served by KCS. It would be unprofitable for KCS to use control of TFM to foreclose this traffic. Second, if TFM, under KCS control, were to raise its division requirements to levels that would cut off UP or BNSF traffic, these carriers could simply shift their traffic to the other gateways, as they have previously threatened to do. Third, almost all of the rail traffic flowing into and out of Mexico is elastic in nature and easily susceptible to diversion to highways or water at the slightest increase in price or reduction in service. Fourth, to the extent the traffic is inelastic, *i.e.* rail dependent, then the rate to the shippers is already as high as it can go and the carriers are simply fighting over what share of the overall through rate each will obtain. Fifth, as UP itself has admitted, most of the traffic is already locked-in via contracts and KCS will have limited ability to divert this traffic to KCS routings. And sixth, both KCS and BNSF are limited in their ability to put a significant amount of traffic over the Tex Mex because of the capacity constraints on their trackage rights over the UP.

Shippers recognize the power of these market forces. No shipper, shipper group, or shortline railroad has filed comments supporting UP's and CP's request for forced negotiations. Likewise, no government agency supports their recommended conditions, including DOT, who believes instead that "parties should be free to negotiate rates privately and freely – with the understanding that rates. . . will be subject to the Board's oversight to protect the public interest." DOT-4 at 20.

Although UP and CP each claim that their suggested conditions merely implement the commitments that KCS has made, their conditions go far beyond KCS's commitments. Almost from the day the two transactions were announced, KCS assured shippers that it would keep the Laredo gateway open and work to improve service. I reiterate that commitment, but the Board should understand that this assurance is not directed for the benefit of our competitors in order to resolve their concerns over the relative bargaining positions of the carriers with respect to divisions. Instead, this and our prior assurances are directed to the shippers to let them know that KCS has no intention of increasing their rail rates or degrading their service. Indeed, as I've stated, the market would not let us do that even if we wanted to do so. We have to continue working with UP, CP, BNSF, and other carriers to assure shippers of reasonable rates to the Laredo gateway.

UP and CP appear to want to protect their divisions and profits, instead of protect rail rates or service to shippers. The Board should not impose their suggested conditions. In fact, their suggestions run the risk of freezing divisions on TFM while leaving UP and CP free to adjust their portions of the rate upward to capture an artificially high share of the profits. Likewise, their suggestions to tie TFM's hands, while leaving UP's affiliate Ferromex unimpeded, seek to tilt the competitive table in Ferromex's favor. Such results have nothing to do with the commitments we have made.

We negotiated the NITL agreement to implement our commitment to keep the Laredo gateway open on commercially reasonable terms and to preserve service. This agreement requires that KCS (1) offer commercially reasonable rates to shippers for traffic to and from Mexico; (2) honor all existing agreements governing rates and divisions over KCS and Tex Mex; and (3) maintain service standards. Moreover, the NIT League agreement recognizes the sovereignty of the U.S. and Mexican governments. This agreement avoids placing the Board in the position of having to involve itself in negotiations between carriers over divisions. KCS believes that the NITL agreement protects shippers' interests and is consistent with this agency's policy of favoring negotiated settlements and allowing the marketplace to govern.

In summary, KCS believes that our acquisition of Tex Mex will have absolutely no anticompetitive effects and therefore warrants no imposition of any conditions. This conclusion does not change when one considers the effects of KCS's acquisition of TFM, and is supported widely by government agencies, shippers, and shortline railroads. In fact, no shipper - not one, not even Pacer - has gone as far as to support UP's, CP's, or BNSF's requested conditions. On the other hand, dozens of shippers, and their largest trade association, the NIT League, fully support the transactions. KCS asks the Board to approve expeditiously its acquisition of Tex Mex.

BEFORE THE
SURFACE TRANSPORTATION BOARD

FINANCE DOCKET NO. 34342

KANSAS CITY SOUTHERN

- CONTROL -

THE KANSAS CITY SOUTHERN RAILWAY COMPANY,
GATEWAY EASTERN RAILWAY COMPANY,
AND
THE TEXAS MEXICAN RAILWAY COMPANY

REPLY OF KANSAS CITY SOUTHERN, THE KANSAS CITY SOUTHERN RAILWAY COMPANY, GATEWAY EASTERN RAILWAY COMPANY,
And
THE TEXAS MEXICAN RAILWAY COMPANY
TO ADDITIONAL COMMENTS FILED SEPTEMBER 30, 2004

SUPPLEMENTAL VERIFIED STATEMENT
OF GERALD K. DAVIES,
EXHIBIT 1

EXHIBIT 1 REDACTED IN PUBLIC VERSION

BEFORE THE
SURFACE TRANSPORTATION BOARD

FINANCE DOCKET NO. 34342

KANSAS CITY SOUTHERN

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THE KANSAS CITY SOUTHERN RAILWAY COMPANY,
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REPLY OF KANSAS CITY SOUTHERN, THE KANSAS CITY SOUTHERN RAILWAY COMPANY, GATEWAY EASTERN RAILWAY COMPANY,
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THE TEXAS MEXICAN RAILWAY COMPANY
TO ADDITIONAL COMMENTS FILED SEPTEMBER 30, 2004

SUPPLEMENTAL VERIFIED STATEMENT
OF GERALD K. DAVIES,
EXHIBIT 2

EXHIBIT 2 REDACTED IN PUBLIC VERSION

VERIFICATION

I, Gerald K. Davies, verify under penalty of perjury that I have read the foregoing statement and that it is true and correct. Further, I certify that I am qualified and authorized to file this verified statement.

Gerald K. Davies

Gerald K. Davies

Executed on 14th of October, 2004.

STATE OF MISSOURI)
) **ss.**
COUNTY OF Jackson)

Subscribed and sworn to before me
on this 14th day of October 2004.

Linda Reeve

Notary Public of the State of Missouri

My commission expires: ____________________

LINDA REEVE
Notary Public - Notary Seal
STATE OF MISSOURI
CLAY COUNTY
MY COMMISSION EXP. AUG. 4,2006

BEFORE THE
SURFACE TRANSPORTATION BOARD

FINANCE DOCKET NO. 34342

KANSAS CITY SOUTHERN

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THE KANSAS CITY SOUTHERN RAILWAY COMPANY,
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THE TEXAS MEXICAN RAILWAY COMPANY
TO ADDITIONAL COMMENTS FILED SEPTEMBER 30, 2004

EXHIBIT B

SUPPLEMENTAL VERIFIED STATEMENT OF
ERASMO SANTOS

SUPPLEMENTAL VERIFIED STATEMENT OF
ERASMO SANTOS

RAILROAD CONTROL APPLICATION
OF THE KANSAS CITY SOUTHERN RAILWAY COMPANY,
GATEWAY EASTERN RAILWAY COMPANY,
and
THE TEXAS MEXICAN RAILWAY COMPANY

BEFORE THE
SURFACE TRANSPORTATION BOARD

FINANCE DOCKET NO. 34342

1. My name is Erasmo Santos. I am employed by TFM, S.A. de C.V. ("TFM") as the Border Superintendent of the Laredo Bridge. My formal business address is Walker Plaza Bldg., Suite 350, 5810 San Bernardino Avenue, Laredo, Texas 78041. However, I actually occupy an office at 2115 Farragut Street, which is located in the Union Pacific Railroad Company ("UP") facility adjacent to the Laredo Bridge.

2. I am offering this Supplemental Verified Statement with regard to the Application filed by Kansas City Southern ("KCS") to exercise control over The Kansas City Southern Railway Company ("KCSR"), Gateway Eastern Railway Company ("Gateway") and The Texas Mexican Railway Company ("Tex Mex"). I have carefully reviewed the Verified Statement of John H. Rebensdorf, submitted as part of UP's Additional Comments, as well as the Verified Statement of Stephen R. Barkley to which Mr. Rebensdorf has referred, and wish to respond to those Statements.

3. As I previously testified, I have acted as the Border Superintendent since November 2001 and have been involved with border operations since 1994. During that

time, I have worked closely with all three railroads that use the bridge -- UP, Tex Mex, and TFM.

4. I continue to believe that I have always administered Laredo Bridge operations in an even-handed manner and have never showed any favoritism to any of the railroads. Also, even though I am employed by TFM, I have never been instructed or ordered to discriminate against UP. Instead, as UP admits, I have routinely "cleared UP trains to cross first more than half the time, reflecting UP's higher percentage of the southbound traffic. The same has been true for northbound TFM blocks intended for UP."[38] No one at Tex Mex has ever disputed this pattern.

5. At page 7 of its Additional Comments, UP repeats the reference to "today's capacity-constrained environment" at the International Bridge. That reference, as well as UP's earlier claim that the "Bridge is operating close to capacity now," is incorrect.[39] Each day, several hours continue to remain available for train operations because neither UP nor Tex Mex has trains available when the previous window closes. As I previously testified, and now repeat, there are times when a gap of three to four hours will occur before UP or Tex Mex will show up with a train.

6. Also, while the windows are established on a six-hour basis, considerable flexibility exists to enlarge a window in order to accommodate a late arrival, especially if the train carries a priority label. In some instances, when it is known that a southbound train is going to be a late arrival, a northbound train, rather than waiting, will be moved before the

[38] V.S. Barkley at 9.

[39] V.S. Barkley at 11.

northbound window is formally opened. Of course, if a train is drastically late, it will have to wait for the next window. Allowing the Bridge operators to actually manage the Bridge operations, rather than to simply oversee the imposition of strict and unyielding formulas, benefits all users of the Bridge. These fluid operating conditions have continued through the past year and will continue indefinitely into the future.

7. I am personally aware that the existing agreements work fine and have worked fine for many years. I am not aware that UP has ever complained that TFM and/or Tex Mex have discriminated against it with respect to the Bridge.

8. I have not received instructions from anyone at KCS, TFM or Tex Mex to change these operating practices. In addition, I have never been told by KCS, TFM or Tex Mex to discriminate against UP. Instead, those companies have fully supported UP's and TFM's efforts to improve the efficiency of the Bridge.

9. The Board should be aware that UP has requested a "waiver of 49 CFR 232.205 - Class I brake test-initial terminal inspection, 232.409 - Inspection and testing of end-of-train devices, 215.13 Pre-Departure Inspection, and 229.201, Locomotive Daily Inspection, as necessary to allow tests and inspections that are performed in Mexico by the Transportacion Ferroviaria Mexicana (TFM) to be considered valid for run-through trains interchanged at the Laredo, Texas Gateway." *See,* FRA Docket No. FRA-2004-18746-1, *Union Pacific Railroad Company Request for Air Brake and Inspection Waivers*, 69 Fed. Reg. 54177, September 7, 2004 ("Waiver Petition").

10. As UP observed in its Waiver Petition, "[t]hese trains are pre-blocked in Mexico and currently receive a Class I air brake inspection and pre-departure mechanical inspection in Mexico at the TFM's yard in Nuevo Laredo. Under present operating procedures, the

trains travel only a few miles before receiving another Class I brake test and mechanical inspection in the United States. UP's proposal, if approved, would save approximately five hours per run-through train and greatly reduce current congestion and increase capacity at the Laredo Gateway." TFM and Tex Mex have supported UP's request.

11. I too personally agree with UP's assessment and believe that if the UP's petition is granted by FRA, it will do far more to alleviate congestion and improve rail operations than would be achieved by the imposition of a condition that could deny me, and those who will follow me, the flexibility to deal with unforeseen developments on a daily basis. Based on my knowledge of operations, I see no reason to interfere with the current system.

12. Although I am headquartered in UP facilities, I have not been approached by UP about any need to negotiate a new operating protocol. In my opinion, which is based on several years of supervising operations at the International Bridge, there is no need to enter into a new protocol, especially when traffic is moving without incident over the Bridge and where, as a practical matter, it can be expected to continue to move without incident after KCS is granted authority to control Tex Mex.

VERIFICATION

On this 14 th day of October, 2004, I, Erasmo Santos, verify under penalty of perjury that I have read the foregoing statement and that it is true and correct. Further, I certify that I am qualified and authorized to file this verified statement.

Erasmo Santos

BEFORE THE
SURFACE TRANSPORTATION BOARD

FINANCE DOCKET NO. 34342

KANSAS CITY SOUTHERN

- CONTROL -

THE KANSAS CITY SOUTHERN RAILWAY COMPANY,
GATEWAY EASTERN RAILWAY COMPANY,
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REPLY OF KANSAS CITY SOUTHERN, THE KANSAS CITY SOUTHERN RAILWAY COMPANY, GATEWAY EASTERN RAILWAY COMPANY,
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TO ADDITIONAL COMMENTS FILED SEPTEMBER 30, 2004

EXHIBIT C

SUPPLEMENTAL VERIFIED STATEMENT OF
DR. CURTIS GRIMM

BEFORE THE
SURFACE TRANSPORTATION BOARD

FINANCE DOCKET NO. 34342

SUPPLEMENTAL VERIFIED STATEMENT OF
DR. CURTIS GRIMM

My name is Curtis M. Grimm, and I am Dean's Professor of Supply Chain and Strategy, Robert H. Smith School of Business, University of Maryland at College Park. I have been a member of this College since 1983. I received my B.A. in economics from the University of Wisconsin-Madison in 1975 and my Ph.D. in economics from the University of California-Berkeley in 1983. My Ph.D. dissertation investigated competitive impacts of railroad mergers.

In my background, I have extensively addressed public policy issues regarding transportation, including those examined in Interstate Commerce Commission ("ICC") and Surface Transportation Board ("STB") merger and control proceedings. My experience also includes working with the Canadian Competition Bureau on four separate railroad matters over the past few years on issues including the effects of U.S. deregulation on Canada, rates and limits for Canadian interswitching arrangements, the acquisition of certain Conrail properties by CN/CP, and a potential alliance of CN and CP in Eastern Canada. In addition, my research has involved deregulation, competition policy, and competitive interaction and management strategy, all with a strong focus on transportation. Further details may be found in the vitae attached to my initial statement. KCS-3/TM-3, V.S. Grimm at 70.

I have previously submitted three statements in this case on behalf of Kansas City Southern ("KCS") and The Kansas City Southern Railway Company ("KCSR"). My initial statement responded to a request by KCS to perform an economic analysis of the KCS purchase and control of Tex Mex, with particular emphasis on the impact on competition. My analysis showed that the control transaction, which is entirely end-to-end in nature, would result in no anticompetitive effects. There are no locations or routing options that would be reduced from two-to-one or even from three-to-two. I was subsequently asked by KCS to address whether my findings that were explained in my initial statement would still be the same if I also took into account the second transaction, KCS's acquisition of the shares of TFM that are currently owned by Grupo TMM. I did so and concluded that there would be no adverse competitive effects from either transaction.

Consistent with STB precedent and economic analysis of similar transactions, the main body of my initial statements examined the horizontal competitive effects from the transactions. Importantly, my conclusion that both transactions have no horizontal competitive effects has not been challenged. Moreover, there have been no changed circumstances during the past year, or any changes in the nature of the consolidation, which alter my conclusions. As such, my unrebutted finding that the two transactions entail no horizontal effects should remain the cornerstone of the STB's evaluation of competitive effects in this case.

The competitive issues which remain in the case, and which have been re-visited in recent testimony, are all vertical foreclosure issues. Most recently, UP has argued that the recent actions by the Canadian Competition Bureau with regard to CN's proposed acquisition of British Columbia Rail ("BC Rail") should serve as a model for STB action in this case. In the remainder of my statement, I would like to first outline principles to be considered by the Board in evaluating vertical foreclosure, apply these principles to the arguments raised by UP and BNSF, and compare the facts of this case to those present in the CN acquisition of BC Rail. As I will discuss, based upon that analysis, I conclude that under the conditions present in the market, in particular strong intermodal competition and the leverage and bargaining power possessed by both UP and BNSF, neither transaction will result in increased prices to shippers or the inefficient foreclosure of UP/TFM or BNSF/TM/TFM routings. Finally, I will address the recent actions by the Canadian Competition Bureau and why they should not be emulated by the Board in this case.

The Appropriate Economic Framework For Examining End-To-End Mergers

The new major rail merger guidelines place greater emphasis on ensuring that gateways remain open in the context of end-to-end mergers. This has been a recent development and appears to recognize that some end-to-end mergers may have anticompetitive effects—a position I have often advocated. DOT has argued that the spirit of the new merger guidelines should be applied in this case. Leaving aside the jurisdictional and legal issues associated with applying the Board's major merger guidelines to KCS's acquisition of control of Tex Mex or to KCS's acquisition of TFM, I will assume *arguendo* that the spirit of the new merger guidelines should apply in this and other future end-to-end transactions.

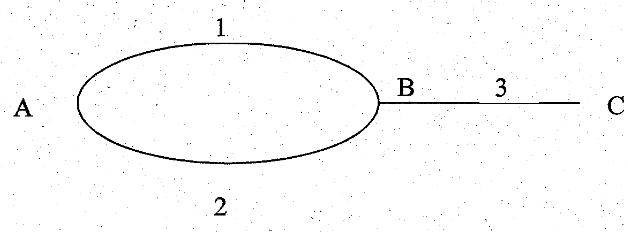
In so doing, it is important to ask: How should the Board proceed in implementing these guidelines, in this case or future cases? The standard theory consistently adopted by this Board has been that efficient interline options will not be foreclosed. I have previously advocated that in some instances this conclusion is unwarranted. For example, there may be some competitive harm in the context of an end-to-end transaction when the unintegrated carrier is allowed to continue to participate in a post-transaction joint-line move, but finds itself forced down to such low margins that over time it cannot cover its fixed costs. This can lead to erosion of interline competitive options even in the context of an otherwise benign end-to-end transaction.

As noted, the STB has rejected such an analysis in the past, but the sense of the new guidelines may indicate rethinking of this issue. Therefore, in so doing, the Board will have to determine what framework it is going to use in assessing whether such intervention is necessary and desirable.

The framework I propose is a case-by-case analysis and not the application of a uniform interventionist policy which ignores individual circumstances. I believe that it is important to assess each case based on specific facts regarding the likelihood of anticompetitive vertical foreclosure. In so doing, the Board should closely examine such issues as the ability of a potentially foreclosed railroad to protect itself, the likelihood that shippers may ultimately pay higher prices, and the likelihood that shippers will see a decline in service.

Such a case-by-case approach allows the Board to determine that intervention, in the form of an appropriate condition, may be necessary in those cases of an end-to-end merger where the unintegrated carrier's bargaining position over divisions would be substantially weakened by the transaction and where that carrier had no countervailing market power. In such instances, where the integrated carrier has superior power in the vertical relationship with rival railroads, it may be possible for the now vertically integrated carrier to raise prices or to force shippers to favor its routings. An example of where there may be harm from vertical foreclosure is where a short line or small railroad loses a friendly connection in conjunction with an end-to-end consolidation of two mega-railroads. Such a circumstance may, in the context of the new merger guidelines, require the imposition of an appropriate condition.

My proposed approach can be illustrated with the familiar rat-tail diagram.



Carriers 1, 2, and 3 are initially independent, with Carriers 1 and 2 serving the A-B market and Carrier 3 serving the B-C market. Carrier 1 acquires Carrier 3, and a potential vertical foreclosure issue arises with respect to Carrier 2. The key initial question is: Can Carrier 2 protect itself against foreclosure? Where it can, then there is no need to impose a condition or to proceed further with the analysis. Where it can't, some form of Board intervention may be necessary, when there is a subsequent determination that shippers will suffer negative rate or service impacts in the absence of intervention.

There are a number of means available in most rail situations where Carrier 2 will be able to prevent itself from being unlawfully foreclosed. Carrier 2 may have options other than Carrier 3 to reach point C. Carrier 2 may originate or terminate captive traffic on its A-B line. Or, the situation may be reversed in other markets, with a Carrier 2 single-line routing in competition with a Carrier 1-3 interline one. The crux of the issue is the relative bargaining power and leverage between Carriers 1 and 2 following the merger. The fact that the merger of Carriers 1 and 3 may alter the leverage between Carriers 1 and 2 in the context of negotiating divisions is not in itself germane, but rather the dual issues are first whether the post-merger leverage between the two carriers is dangerously unbalanced as a consequence of the merger, and, second, whether this imbalance is likely to result in shipper rate increases or decreases in service.

Application Of This Framework To The Transactions

Examining the vertical foreclosure issues of the KCS/Tex Mex and KCS/TFM transactions by applying the case-by-case framework described above in the spirit of the Board's new merger guidelines, I can unequivocally state that neither the KCS/Tex Mex nor KCS/TFM transaction will allow KCS, in a post-merger environment, to vertically foreclose UP or BNSF in this market. There is no danger that rates to their shippers will be increased or service degraded. Nor will the transactions allow KCS to force inefficient routings over a combined NAFTA Rail system. In short, the powerful leverage of UP and BNSF, along with other market conditions, is sufficient to prevent either transaction from having anticompetitive effects that would warrant imposition of a condition.

1. There Is No Basis For UP's Requested Conditions

The current status quo provides UP with enormous leverage and bargaining power with regard to interline relationships in the U.S.-Mexico rail market. While a consolidation of KCS with Tex Mex and TFM will improve their ability to compete and should strengthen their bargaining position vis-à-vis UP, UP will still maintain a dominant position in the balance of power. UP's dominant position, combined with other market factors, will prevent KCS from forcing inefficient routings, raising prices to shippers, or degrading service.

Many factors provide UP substantial leverage and vertical power in its vertical relationships with NAFTA Rail, and will provide ample protection versus any KCS vertical foreclosure attempts. These factors have been well-documented in the record of this transaction. First, Union Pacific is the largest of the Class I carriers, accounting for over one-fourth of total rail industry revenue and almost one-fifth of total rail industry track miles. NAFTA Rail, in its entirety, would have less than one-eighth the revenues of UP. This size mismatch provides UP with enormous leverage in determination of rate divisions and rail routings.

Second, UP now dominates cross-border traffic. For example, UP's market share for Laredo Northbound traffic is 91% based on 2001 data; UP's share for Laredo Southbound traffic is 71%. This virtual monopolization of traffic in the U.S. portion of U.S./Mexico movements provides UP with substantial leverage.

Third, UP has a great deal of U.S.-Mexico traffic tied up under long-term contracts, so that shifts in routing or divisions are not even an option for quite some time. Even when those contracts expire, UP has so many captive shippers and such an extensive network coverage for U.S.-Mexico traffic that it would be very difficult, if not impossible, for NAFTA Rail to reroute this traffic or to refuse to work with UP.

Fourth, UP has alternative gateways to Mexico and can thus protect itself against foreclosure by shifting traffic or threatening to do so. For all traffic to and from the U.S. and Mexico, UP carries 90% of the Northbound traffic and 79% of the Southbound traffic, with access at multiple rail gateways. In addition, UP owns 26% of Ferromex, TFM's competitor in Mexico.

Finally, added to all these factors, which amply protect UP's market position, Tex Mex must operate over UP's infrastructure to connect TFM with KCSR. As such, NAFTA Rail's ability to compete with UP at Laredo depends largely upon the dispatching, maintenance and investment practices of UP.

When evaluating the outcome of interline relationships following an end-to-end merger in the case, the key is the bargaining power of KCS and UP following the merger, not simply whether there is a change in bargaining power from the merger. Clearly, NAFTA Rail will not even come close to having the upper hand in its relationship with UP following the merger. Given this situation, there is no basis for the contention that this consolidation will result in vertical foreclosure, and no basis for UP's requests for STB intervention or imposition of requested conditions.

2. There Is Also No Basis For BNSF's Concerns

Similarly, BNSF has substantial leverage in it's interline bargaining with KCS from most of the same factors as does UP. As does UP, BNSF dwarfs NAFTA Rail with respect to overall size, with annual revenue of approximately $9.4 billion and ownership of approximately one-fifth of total railroad track miles in the country. Traffic diversions from BNSF due to the proposed KCS/Tex Mex transaction were estimated in this proceeding to be approximately $6.8 million annually. Clearly such diversions on the BNSF revenue base will not weaken BNSF as a competitor so as to warrant finding an anticompetitive effect in a post-merger environment.

Likewise, KCS's control of Tex Mex and TFM will not allow KCS to raise rates to BNSF shippers or force inefficient diversions to the NAFTA Rail system. If KCS attempted to take such actions, it risks losing a substantial amount of revenue because BNSF will simply shift gateways. BNSF has historically made significant use of gateways other than Laredo and its own route structure facilitates this result. As noted previously in the Rebuttal Verified Statement Of Gerald K. Davies, BNSF has, in the past, split its U.S.-Mexico traffic almost evenly between TFM interchanges at Laredo and Brownsville and Ferromex gateways at El Paso and Eagle Pass. (KCS-18B/TM-17B, Tab F at 13). If KCS were to use its control of Tex Mex to attempt to raise divisions beyond commercially reasonable rate factors, to inefficiently foreclose BNSF traffic, or to "close" the Robstown gateway, BNSF will simply retaliate by shifting traffic to its Eagle Pass or El Paso gateways.

Finally, KCS has very few competitive origins or destinations where it competes with BNSF so as to make inefficient foreclosure of BNSF interchanges even a viable theoretical option. As detailed in the Verified Statement of Bengt Mutén, BNSF and KCS jointly terminate Laredo traffic in only 3 of 388 Northbound markets and originate Laredo-bound traffic in only 6 of 1099 Southbound markets. *See* KCS-18B/TM-17B, Tab G at 7. Thus, even assuming KCS had the economic power to foreclose BNSF at these locations, which it does not, there is no way that KCS could use these locations to make up the losses that it would suffer due to BNSF retaliation at remaining BNSF-served locations.

There is no basis for the contention that vertical foreclosure will occur following the NAFTA Rail consolidation, and no basis for STB action to freeze interline divisions. BNSF can amply protect itself from unlawful vertical foreclosure. This point is further strengthened by KCS's agreement with the NIT League, which requires KCS to quote rates for BNSF shippers who desire to route via Robstown and the Laredo gateway.

<u>The CN/BC Rail Example Does Not Provide A Good Model</u>

As previously argued, if regulators adopt a more activist approach to vertical foreclosure issues, evaluation of vertical foreclosure and prescription of regulatory remedies must be done on a case-by-case basis with careful attention to specific facts, particularly the ability of carriers facing potential foreclosure to protect themselves. While a full evaluation of the CN's acquisition of BC Rail is clearly beyond the scope of this filing, an initial evaluation reveals a number of salient differences between that consolidation and the instant transaction. Indeed, the situation sheds further light on how vertical foreclosure should be evaluated, and how different conclusions may be reached case-by-case depending on the relevant facts. The differences in the NAFTA Rail transaction and CN's acquisition of BC Rail include the following:

1) CN/BC Rail contains an important horizontal aspect, which contributes to the vertical foreclosure concern in that the unintegrated carriers lose both "friendly" connections as a result of the consolidation. CN and BC Rail serve many of the same origins and destinations in the region and thus compete for grain traffic in the British Columbia area. They are the only two competitors for many grain shippers in that region. By contrast, as pointed out above, the NAFTA Rail consolidation has no horizontal effects.
2) Carriers connecting with BC Rail have no alternative railroads providing access to shippers in the British Columbia hinterlands. This contrasts sharply with UP's and BNSF's ability to access Mexican shippers through alternative gateways and Ferromex.
3) The strength of intermodal competition may well vary between this transaction and NAFTA Rail. As has been pointed out in this case, water and truck competition are strong in the U.S.-Mexico market and provide further protection for shippers from vertical foreclosure concerns.
4) While we are not privy to the details, the CN/BC Rail consent agreement indicates that shipper input played a role in the outcome. There may well have been shipper concern in the CN/BC Rail case, while relevant shipper opposition and expression of foreclosure concerns in the NAFTA Rail transactions has been minimal and the nation's largest trade association for shippers actually supports the transactions.
5) Most BC Rail traffic is currently interchanged with CN, as opposed to KCS originating or terminating a very small percentage of TFM interline traffic. Again this is a factor which can affect vertical foreclosure assessments. The CN/BC Rail model would thus be far more appropriate if UP, not KCS, were merging with TFM.

In sum, an appropriate approach to vertical foreclosure issues involves careful assessment on a case-by-case basis of the likelihood of foreclosure and the ability of rival railroads and shippers to protect themselves. Even a cursory examination of the CN acquisition of BC Rail, based on the documents supplied by UP, reveals a number of critical differences in the two mergers. As such, the actions of the Canadian Competition Bureau provide no basis for STB action in this consolidation.

The actions of the Canadian authorities are in fact more relevant to this case in two ways not mentioned by UP. First, note that the CN/BC Rail action was taken by Canada's equivalent of our Department of Justice Antitrust Division. Indeed, our own DOJ had jurisdiction over the TFM transaction under Hart-Scott-Rodino and examined very carefully the vertical foreclosure issues raised by UP. The DOJ could have issued a second request and ultimately conditioned their approval of the transaction on some type of "consent decree" as did their Canadian counterparts in CN/BC Rail. The U.S. DOJ opted, after a careful evaluation of the facts, not to issue a second request in the KCS/TFM transaction.

Second, the CN/BC Rail consent decree clearly illustrates the challenges in regulatory intervention to solve vertical foreclosure concerns. The resulting document and process necessitates setting prices and service standards over a variety of markets and movements, with clear implementation challenges. A parallel process for U.S.-Mexico movements would be much more extensive, given the relative complexity of TFM versus BC Rail, and would by necessity involve the setting of Mexican rates and services. Thus, the CN/BC Rail agreement illustrates clearly the alternative path the STB would go down if it adopted UP's recommendation to intervene in the negotiations of interline divisions and service. I strongly believe that such a path would not represent good policy here given the facts of this case.

Conclusion: There Is No Basis For Conditions As Requested By UP and BNSF

Even if the STB applies the spirit of the new merger guidelines in this proceeding and determines to adopt a more activist approach to vertical foreclosure issues, there is no basis for Board intervention in this case in the manner of potentially fixing divisions or intervening in interline negotiations. UP and BNSF are amply protected by their enormous leverage against any potential NAFTA Rail vertical foreclosure. Neither the Tex Mex nor TFM consolidation will result in increased prices to shippers or the inefficient foreclosure of UP/TFM or BNSF/TM/TFM routings. Market conditions are sufficient to prevent either transaction from having anticompetitive effects.

VERIFICATION

I, Curtis M. Grimm, verify under penalty of perjury that I have read the foregoing statement and that it is true and correct. Further, I certify that I am qualified and authorized to file this verified statement.

Curt Grimm
Curtis M. Grimm

Signed: 10/13/04 (Date)

STATE OF MARYLAND) **ss.**
)
COUNTY OF PRINCE GEORGES)

Subscribed and sworn to before me
this 13th day of October, 2004

Rowena White
Notary Public Of The Sate Of Maryland

My commission expires: 12/1/04

CERTIFICATE OF SERVICE

I have this day served a copy of the foregoing Reply Of Kansas City Southern, The Kansas City Southern Railway Company, Gateway Eastern Railway Company, And The Texas Mexican Railway Company To Additional Comments Filed September 30, 2004 upon all other parties of record by depositing a copy in the U.S. mail in a properly addressed envelope with adequate first-class postage thereon prepaid or by other expeditious means.

Dated: October 15, 2004

William A. Mullins
Attorney for Kansas City Southern,
The Kansas City Southern Railway Company, and Gateway Eastern Railway Company